PACIFIC TRADE AND DEVELOPMENT

Papers and Proceedings of a Conference
held by The Japan Economic Research Center
in January 1968

Edited by
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PREFACE

The Japan Economic Research Center held an international conference from January 9 through 13, 1968 on the subject of "Pacific Trade and Development". Contained in this book are the papers and proceedings of the conference.

Trade policies in the Post-Kennedy Round world are fluid and searching for new direction. The devaluation of the pound sterling and its effect on gold and the dollar were a severe shock for the Pacific countries. A restructuring of European trade can be anticipated. The North-South problem is soon to be debated again in New Delhi.

At this time, there seems an urgent need to promote Pacific economic cooperation, to develop measures for expanding trade among Pacific countries, and to promote trade and aid for developing countries in Asia and Latin America. The fluidity in world trade policies and the uncertainty in world trade and monetary arrangements serve to emphasise the urgency of this task.

The conference was originally planned with a very humble desire to promote keener interest in economic development and trade expansion among countries in the extended Pacific area, including Asian and Latin American developing countries. These countries have huge potential for future development. The importance of this potential has tended to be neglected in the past.

At the end of very intensive and fruitful discussions which ranged over a wide area of trade and aid problems in the extended Pacific area, we are full of enthusiasm and confidence that it is really worthwhile to study further and deeply the feasibility, as well as difficulties, of the establishment of a Pacific Free Trade Area. Our studies should certainly stimulate, within 3 or 5 years, moves by nations around Pacific Basin towards closer economic cooperation. This would benefit not only trade expansion among advanced countries but also for the economic development of Asian and Latin American developing countries due to the joint aid efforts which could be more effectively realized through the closer partnership of advanced Pacific basin countries.

As indicated in the final communique issued by the conference, our study should be continued, and our study should be academic and free from various pressures except truth.

Our study is, however, policy oriented, and, it is hoped, the results of our study will contribute to policy-making for the benefit of nations in the extended Pacific area.

Finally, we would like to express our sincere thanks to the members of the secretariat and others who made the meeting so successful.

Kiyoshi Kojima
Chairman of the Organizing Committee
for "Pacific Trade and Development"

Saburo Okita
President of the Japan Economic
Research Center

January, 1968

COMMUNIQUE

A conference on Pacific Trade and Development was held under the sponsorship of the Japan Economic Research Center from 11-13th January 1968 to discuss the trade needs and policies of advanced Pacific countries and the aid and trade needs of less developed countries, especially in Asia and Latin America. Economists from Australia, Canada, Japan, New Zealand, the United Kingdom, and the United States participated in the Conference.

Discussion ranged over a wide area of trade and aid problems. These included consideration of a proposal for the formation of a Pacific Free Trade Area as a means for promoting freer trade and higher income levels generally.

The potential gains from such a free trade area were fully recognized. No less clearly recognized was the fact that not all the economies concerned are ready for any immediate move to free trade. Economic gains, while definite, may well be unevenly distributed between countries and, in all, there are difficulties which prevent the adoption of any such proposal in the near future.

Moreover, a Pacific Free Trade Area is not the only possibility. Alternative international economic strategies are open for consideration. The best course for Pacific area countries, developed and less developed alike, would, for example, be affected by the outcome of Britain's application to join the EEC. Again, the best combination of aid and trade policies for all countries concerned with development in the Asian/Pacific Area will be affected by the outcome of the important official discussions to take place at the forthcoming meeting of the U.N. Conference on Trade and Development in New Delhi. Any consideration of regional trade groupings must include careful assessment of the effects of such proposals on trade access for developing countries to the markets of the advanced countries.

While recognizing all these problems, however, the Conference agreed 1) that there was a strong case for step-by-step moves towards close co-operation in trade policies among Pacific economies and 2) that there was also a strong case for more co-ordination in their aid policies. This co-ordination is needed not only to increase the effectiveness of aid as an instrument of economic development but also to relate aid to the expansion of export earnings by developing economies.

COMMUNIQUE

Participants in the Conference stressed the need in member countries both for continued public discussion of these important problems and for their regular consideration by governments. The Conference welcomed an offer by the hosts and H.P. Jones, Chancellor of the East-West Center in Hawaii, to confer on arrangements for a further conference in about a year's time.

January 13, 1968

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Chapter 1 CANADA AND PACIFIC TRADE POLICY

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The purpose of this paper is to indicate the nature of Canadian views on the economic and political significance of international trade policy for Canada and, in particular, to assess the probable implications for Canada of trade liberalization among the countries of the Pacific area.

I The Historical Development of Canada's Trade Relationships

In assessing Canada's interest in international trade policies, it is important to examine both the historical record and present circumstances. While many of the historical factors which have governed Canadian policies are still operative, the postwar period has generated both new trading relationships and new considerations affecting our traditional relationships.

Historically, Canada's interests have related primarily to its unique relation to the United States, to the British preferential system, and to the domestic purposes which trade and trade policies serve. Ever since the interior of the North American continent became an economically-accessible locus of agricultural and industrial activity, about the middle of the last century, Canadian and U.S. economic destinies became interlocked. Many of those who developed one of the first manufacturing industries of the Ottawa valley were U.S. lumbering men from New England who saw their opportunity in a vaster supply of Canadian resources and the waiting demand in the markets for construction materials in the United States as well as in Britain. It should be added that the development of that industry was assisted by the reciprocity agreement of 1854, under which squared timber and other commodities important to the trade potentials of the time could pass freely across the border.

The first experiment in Canada-U.S. reciprocity broke down in 1866, partly as a result of the nationalistic aftermath of the American Civil War and partly as a reaction to imposition of new Canadian duties on products not covered by the treaty, which nevertheless undermined U.S. enthusiasm for reciprocity. Interest in a renewal and extension of reciprocal free trade was subsequently expressed repeatedly. At first the United States resisted the idea, partly on grounds of fear of competition from British manufacturers, but later efforts were resisted mainly by Canada, which by 1880 had adopted a protective tariff to support manufacturing industries. In 1911, a reciprocity agreement became one of the principal issues (but not by any means the only issue) on which a bitter election was fought and the government defeated. From then until after the Second World War, the issue was not seriously debated.

The British connection was the other main feature of Canada's historic trade relationships. From 1846 until comparatively recent times, trade between Canada and Britain was governed by a rather asymmetrical trade policy. For its part, Britain, while in the vanguard of modern industrialization, rejected protection, and Canada, being an increasingly competitive supplier of the foodstuffs and raw materials which comprised Britain's main imports, found in Britain its principal market in the years before the First World War. Canada, as a colony with a young economy, was permitted tariffs both for revenue and a measure of protection for manufacturing. Throughout the period before 1914, this relationship thrived, the more so as Canada opened up the west, shipping grain primarily across the Atlantic, and buying back the capital goods which established transportation links with the west, and consumer goods for a growing population. The inflow of British capital helped to avoid the financial embarrassments of rapid development, and made Canada a classic case for the study of the transfer mechanism.

Perhaps the most important practical aspect of Canada's trade policy toward Britain is that the importance of the British connection and of the British market helped to ensure that Canada did not discriminate against British goods even when they were the most important source of import competition. It is also significant that we began to discriminate in favour of British imports only in the interwar years, by which time the United States and other countries were becoming the most competitive suppliers of many manufactured goods demanded in Canada. The essence of the famous (or infamous) Ottawa agreements of 1932 was to achieve preferences in trade between members of the Commonwealth and Empire by raising tariffs governing imports from non-members. Thus the sources of imports were shifted to a degree, in Canada's instance favouring British exports at the expense of the United States and, to a lesser degree, Europe and Japan. But the principal purpose of the exercise in the 1930s was to ensure that imports should not comprise an increasing share of the depressed domestic market.

The legacy of the British preferential system has not been nearly as great as its critics or most enthusiastic supporters have claimed. In the Canadian case, even before the outbreak of war, Canada and the United States had begun to reduce their most restrictive barriers, and for the postwar years the supply problems of recovery dominated trade barriers as a factor limiting the growth of Canadian imports from all but the United States. Even now that these have been largely overcome, Britain has had to share the Canadian market with other European exporters.

Though a number of manufacturing plants were established in Canada in the interwar years to take advantage of the Commonwealth preferences, these have remained to exploit primarily the Canadian market now that other Commonwealth countries have increased the protection accorded to their own manufacturers. Perhaps the only really important continuing opportunity which dates from the Ottawa agreements has arisen from the free access to the British market itself enjoyed by Canadian manufactured exports. Of course, this was meaningful for Canada only after the pound had been made convertible again in the late 1950s, and once Britain had applied for entry to the EEC, Canadian producers could be excused for not regarding the marketing opportunities in the United Kingdom as of lasting importance.

Canada's trade with countries other than the United States and Britain has grown substantially in importance in recent years. In assessing this development, we should not confuse short-run with more fundamental shifts. For example, the rise since 1950 in Canadian imports from the countries which are now members of the EEC has been marked (from 2.1 percent to 5.6 percent of Canadian imports), but the percentage of total imports which come from those countries has in fact returned to the relative position which prevailed in 1929. On the import side, the really striking long-term changes have been the decline in the importance of Britain (from 15.3 percent of Canadian imports in 1929 to 7.6 percent in 1963-65) and the growth from 9.1 percent to 15.1 percent in the role of countries outside North America and Europe.[1] Japan (supplying 2.4 percent) is clearly the most important single source, being Canada's third trading partner, though on the import side far behind the United States (69 percent) and only one third of the United Kingdom (with 7.6 percent). Other regions showing marked growth are: Central and South America, now 7.3 percent (compared with 4.1 percent in 1929); middle east and Africa, now 2.5 percent (compared with .4 percent in 1929); other Asian areas, now 1.9 percent (compared with 1.6 percent in 1929). Only Oceania, dominated by Australia and New Zealand, has declined in importance. The growth reflected in imports from developing countries is partly the result of expanded imports of petroleum and tropical products, and in part a growth of imports of light manufactured articles.

Canada's exports have also shifted in direction, and here the changes have been even more marked. Britain took 14.4 percent of Canadian exports in 1963-65, but this compares with 34 percent in the late 1920s. The EEC countries have also declined in relative importance, from 10.5 percent in 1928 to 7.1 percent in 1963-65. The 50 percent relative decline in the role of western Europe as a customer for Canadian imports has been balanced by a rise from 39.6 percent to 55 percent in U.S. share of Canadian exports, and growth in Canadian markets in east Europe, Japan and the developing countries. East Europe now takes 4.3 percent (were negligible in the late 1920s), Japan now takes 4 percent (2.7 percent in 1928), and the developing countries now take 9.9 percent (6.8 percent in 1928).

Two principal trends are reflected in these figures -- the growth of east European, Chinese, and Japanese markets for Canadian wheat; and the rise of Canadian exports of a wide variety of manufactures, especially to the United States.

The principal conclusions which emerge from the foregoing discussion of Canadian trade history are two: 1) That although Canadian trade is still primarily with the United States, it is very much more diversified than in the past, with manufactured goods playing a large role especially in Canada's exports. 2) That Japan, East Europe, and the developing countries are of growing importance both in imports and exports and together comprise a share of Canadian trade which is approaching equivalent importance to Canada's trade with Europe.

With the growth of the Canadian economy, the importance of international trade for Canada has declined slightly, though dependence upon trade in a few staple commodities has decreased more markedly, thanks to the diversification of processing and manufacturing activity. While the U.S. marfket has become more important than ever for Canada, the degree to which Canadian vulnerability (whatever that is defined to mean) has been increased is questionable. Insofar as trade with other countries provides a counterweight (economic and political) to the relationship with the United States, the non-European world offers as much (if not more) promise as the European.

II Canada's National Policy

If Canada-U.S. trade and Canada-Commonwealth trade were two of the pillars on which Canadian trade policy has rested, the third pillar on which Canadian trade policy was founded was the protection of domestic industry. What began largely as revenue tariffs were converted into a program of support for processing and manufacturing with the introduction of the national policy in 1879. This policy has remained in effect ever since, with modification according to the needs of Canadian export industries. Insofar as these needs required reduction or elimination of trade restrictions on partly-processed natural resources, it was not difficult for Canada to make deals with her principal trading partners which enabled each to export the raw materials in which it enjoyed an absolute or comparative advantage. This was particularly so for Canada-U.S. trade, since these countries were and are major producers of a wide (and in part complementary) range of such products. So long as the Canadian economy was small and undeveloped, there was also little difficulty in permitting imports of many iron and steel products, capital goods, and textiles from Britain, while leaving some scope for local industry. As the economy matured, however, the comprise became more and more difficult, and the structure of the Canadian tariff now reflects an awkward attempt to serve conflicting interests.

This is nowhere more apparent than in machinery and industrial chemicals industries.2/ Because of the requirements of the export-oriented resource industries for material and equipment inputs at prices comparable to those paid by comparable to those paid by competitors in other countries, low tariffs have been established on the categories of commodities these industries purchase. In some cases such tariffs apply generally (i.e., to all imports of such commodities), while in other cases only if the commodity is being imported for the particular industry (in which case it is labelled an "end-use" item). This presents little problem if the item is sufficiently specialized to have only a small market in Canada and could not be produced economically in Canada for sale in the continental or world market. But for items in which the Canadian market is sufficient to support production at an economic scale, or in which it could exploit a comparative advantage if it were not for trade restrictions, the compromise arrangement is unsatisfactory because it serves the interest of traditional export industries at the expense of potentially strong domestic industries or newer export industries. The situation is well illustrated in contrasting the experience of chemical fertilizers and petrochemicals or of agricultural machinery with other widely used lines of industrial and mining machines. Because of the strength of the agricultural sector in the political process in North America, tariffs on chemical fertilizers were eliminated. Since important chemicals for fertilizers have been produced in Canada as a byproduct of non-ferrous metals production and represent an economic source for the international market, Canada has become an important exporter of chemical fertilizers. In the petrochemical area, increased opportunities have opened up with the development of Canadian petroleum resources. But the international market is not available, because of trade restrictions, and the available domestic market for petrochemical derivatives is reduced by the end-use items permitting imports. Thus the compromise between protection of manufacturing industries and measures to ensure the competitive position of Canada's traditional export industries has become less and less satisfactory as the opportunities for production of processed intermediates has improved.

In the case of agricultural machinery, as with chemical fertilizers, the political strength of agricultural interests brought about the elimination of most relevant trade barriers. The consequence has been a rationalization of North American production, with Canadian plants of each of the principal firms specializing in some products and American plants in others. Because the North American market for these products lies near the centre of the continent, the location of production has favoured the south end of Lake Michigan. Nevertheless, the ratio of Canadian exports to imports of these products has continued at approximately the same level as it was before the achievement of free trade, though exporters are now more specialized and a higher proportion of Canadian exports go to the United States rather than overseas markets. In other words, specialization within the manufacturing industry has taken the sort of course economic theory would lead one to expect. It should be added that this happened in spite of several aspects of the situation which worked against the industry and obstructed its ability to exploit fully the opportunities for production in Canada. While most tariffs on agricultural machinery have been eliminated, tariffs affecting some of the industry's inputs remain and also tariffs on some other lines of equipment produced by agricultural machinery firms (for example, construction equipment). Since the market for most other lines of equipment is concentrated more in east of North America, the lack of free trade in such products favours the location in the United States of related production lines by agricultural machinery firms. Many kinds of industrial machinery which are widely used in Canadian resource industries or in a variety of manufacturing industries are now produced in Canada, and if export opportunities were opened up, producers of such machinery would no longer require protection to compete with imported machinery, though a transition period would be required to develop specialized production and the related export market.

These illustrations indicate the contrasts which may be found in Canadian manufacturing activity today. They are part of the changing pattern of the Canadian economy, the evidence of a degree of maturity which has been achieved in part because of the national policy, but perhaps mainly in spite of it. Until the First World War, Canada was mainly a producer of products of the farm, the fishery, the forest, and the mine, with agriculture being by far the dominant. All manufacturing activity, including much that was processing of primary products, totalled much less than the primary industries.3/ By the late 1920s, the contribution of manufacturing to the gross domestic product about equalled that of primary producers. By the mid 1950s, manufacturing was more than twice as important -- this in spite of marked absolute growth in the primary sector, particularly in mining, in which during the period in question (1929-56) both iron mining and crude petroleum production became for the first time significant contributors to Canada's primary product output. Furthermore, the aggregate for manufacturing now comprises a much more diversified range of production, with complex manufacturing categories such as electrical apparatus, transportation equipment, and chemical products contributing a very much higher percentage of the value added in manufacturing.

An important feature of the change in the past forty years has been growth in the domestic market. The population of Canada has doubled, and well over half of the current population of Canada lies in a narrow band within fifty miles north of the U.S. border and extending from Windsor to Quebec City. Furthermore, the per capita GNP in constant dollars has also doubled in the forty years. This means that there is now in eastern Canada a market base on which a wide range of manufacturing can be -- and is being -- based. The market for particular consumer durables products, and for the principal types of intermediate goods and industrial machinery, has grown from inconsequential levels in the interwar years to a size that would support one or more production units of efficient scale (by which I mean plants that could achieve cost levels comparable to those in the United States).

Now I was to make clear exactly what I do and do not mean by this. I do not mean that many Canadian industries are at present so organized as to achieve internationally competitive cost levels. Nor do I mean that such levels would characterize the production of a wide range of products even if industrial organization were fully rationalized. In the kind of industries which serve the wide range of specialized intermediate functions characteristic of a capital-intensive economy, the variety of products is enormous, and the volume requirements differ widely. Except where scale economies are unimportant, the Canadian market for most of these is not large enough to warrant production in Canada on the basis of domestic sales alone, and, for those more specialized products, only if international markets are accessible will production in Canada be likely to develop. Canada is now an importer of specialized machinery and equipment and particular-purpose rolling mill products and chemicals. But the one-tenth or less of machinery or equipment types which are most in demand in Canada comprise a very large fraction of the total demand for equipment, and it is these larger volume items which Canadian producers now find themselves able to supply in competition with imports.

Of course, the selection of products cannot be based on market size alone. The technology of production and distribution requires that much larger markets be available for some products than for others. This may be because of the elaborate and expensive capital needed in production processes (as in steel, automobiles, and other consumer durables): it may be because of the expensive research and development facilities needed to keep a company abreast of others in the field (chemicals, electronics, and aero-space industries): or it may be because selling and distribution outlays have become an important feature of the oligopolistic rivalry in certain industries. Of course, the last two of these factors need not affect production location. They bear more particularly on the need for a firm size which exceeds plant size. That Canadian industry has not played a major role in integrated production of typewriters and certain types of electrical appliances seems to be explained by the scale required for such activities and the limited scope for separating the assembly function. However, minimum efficient scale of plant is not so large as to impose on Canadian manufacturing a serious constraint in itself.

What has happened in the Canadian automobile industry in connection with the 1965 Canadian-U.S. agreement is illustrative. Although scale of production is very important in this industry, Canadian assembly plants have become specialized in production of fewer models. Many parts requiring relatively small volume in order to achieve competitive cost levels are produced in Canada. For the components produced efficiently only in very large volume (in order to spread costs of expensive dies, etc.), imports from the United States are more important. Although integration in this North American industry has assisted specialization at all levels of production, it is important to recognize explicitly that the integration has helped mainly to overcome the disadvantages arising out of having three or four producers with a wide variety of product lines. Had the industry been more concentrated in either or both of two ways -- fewer manufacturers or fewer models -- the Canadian market alone would have been able to support efficient integrated production units requiring (at the most) to import only certain standard components such as automatic transmissions.

The automobile industry is atypical in most respects, since the size of operations and extent of product differentiation exceeds that in most industries. However, in two other respects it has been representative of the situation in quite a few Canadian industries. It is one of several industries in which the combined effect of tariff protection and foreign ownership has contributed in the past to an inefficient industry. Tariff protection has permitted the maintenance of diversified production units characterized by small volume production of particular products or models, and an oligopoly situation in which pricing has been based on the tariff, and the high degree of interdependence of the oligopolists has created potentially very unstable pricing and market behaviour. Foreign ownership has increased the number of firms established in Canada, since leading U.S. firms have endeavoured to achieve in Canada a relative market share at least as large as they have in the United States. This has made it more difficult to achieve the economies of scale in Canadian industry and heightened the fear of price competition. This inefficiency, which the tariff has done much to generate, has made individual firms advocates of continued protection, and since foreign subsidiaries have been established in Canada behind the tariff, some Canadian government officials and apparently also the management of some of the subsidiary firms are afraid that foreign head offices would not be prepared, without special incentives, to integrate their Canadian production facilities into continental or worldwide marketing arrangements. This is one of the reasons for the direct agreements between the Canadian government and the automobile companies.

The foregoing observations on the problems of Canadian manufacturing industries consisted of illustrations taken from particular industries. There have recently been a number of more general analyses of Canada's productivity problem. One of these, by Professor N. H. Lithwick, has focused on the fact that there has been a poorer productivity record in manufacturing than in other sector of the Canadian economy.4/ He cites the ratios between U.S. and Canadian capital, labour, and output and finds that they are, respectively, about 9:1, 12:1, and 15:1. He notes that U.S. manufacturing output per worker thus exceeds that in Canada by 22 percent, and when the difference in capital is taken into account, U.S. productivity advantage is estimated at 30 percent. Among the various factors which may explain this difference, he concludes that the foremost is, no doubt, the inefficiency introduced into the Canadian economy and perpetuated by our tariff policy. This carries greater conviction when it is noted that the efficiency effects of commercial policy bear almost entirely on manufacturing. (Other sources of productivity differences between the two economies, such as educational attainments, do not bear particularly on manufacturing.) A recent estimate of the cost of the tariff, by the Professors Ronald and Paul Wonnacott, suggests that the Canadian tariff and the U.S. tariff together may reduce real per capita income in Canada by at least 10 percent.5/ Many of the effects are indirect. For example, the higher cost of capital equipment which reduced the U.S./Canada capital rates is partly attributable to the tariffs on machinery and equipment and components. Again, insofar as lower Canadian R & D expenditures restrain Canadian manufacturing productivity, they are in fact held back by the smaller market available to Canadian firms, and the reduced opportunity to spread the costs of developing distinctive Canadian products.

One is drawn to the conclusion that Canada needs a substantial change in commercial policy as the cornerstone for a growth policy designed to take advantage of the enlarged domestic market base and to improve productivity by specialized production and export. This is a need which most of the smaller industrialized states have long since realized, the Netherlands and Sweden being good examples. Perhaps because these countries are substantially smaller than Canada, they have recognized that their manufacturing activity would have to depend on external as well as domestic markets, while Canadians have flirted with the idea that with a growing population they could afford to wait for their industries to become cost competitive on the base of the domestic market alone. For reasons already cited, this has proven a costly approach, and one which it is neither necessary nor wise to continue.

III Political Considerations Affecting Canadian Trade Policy

Whether Canada is likely to be a willing participant in any trading arrangement which would help to achieve improved productivity will depend on both domestic and international politics. The domestic political scene in Canada is not promising. During the past five years, successive Canadian governments have shown little active concern for intermediate or long-term economic problems, and particularly not with international economic policies. Part of the preoccupation has been the consequence of minority federal governments and the urgent domestic problem of national unity and federal-provincial relations. Among economic policies, there was more concern for restoration of full employment until 1965, and subsequently, recurring worry over inflationary pressures. Meanwhile, the growing demands for resources for such social purposes as improvement of transportation, education, and health services has put pressure on public revenues, and in view of the division of responsibility for such services, sharpened the controversy over distribution of revenue sources between federal and provincial governments. Only very recently has there been much stress upon the possible relevance of trade policies to these issues. There is now a growing realization that Canada's capacity to sustain full employment without severe inflation, and to finance public services, both federal and provincial, are likely to be promoted by the more competitive and productive economy which freer international trade and related policies can make possible.

One of the important aspects of any assessment of the domestic political implications of elimination of trade barriers is the regional impact. It has always been argued that the outlying regions of Canada have borne disproportionately the burden of the tariff, because it has served to protect higher cost manufacturing activity located largely in the central provinces. Recent reassessment of the regional implications of removal of trade barriers in the light of the improved potential and reduced locational disadvantages already mentioned has indicated that the greatest beneficiaries of the elimination of trade barriers in Canada would be the central provinces, Ontario and Quebec, because it is these provinces which have the greatest unrealized productive potential. Thus, the Atlantic and western provinces would gain from the lower relative costs of manufactured products and the advantages of better access to external markets and suppliers, while the central provinces would now experience, in addition to the above gains, the gains in productive efficiency and competitiveness. They face, of course, more of an adjustment problem, but as in the automotive case, the nature of the adjustment should be largely within firms, in the internal organization of production or the pattern of specialization.

These economic considerations should make it more attractive for Canadian political parties to adopt bold trade policies. The major economic deterrent, apart from failure to study and appreciate the changing character of the Canadian economy and its policy needs, may well be excessive preoccupation with the transitional costs and their immediate effect on electoral success. A departure from minority government and new leadership for the governing party (whichever it is) can play an important role in placing such problems in perspective.

One of the problems facing Canada's political leaders is that the albatrosses of traditional doctrinaire positions still hang around the necks of the two largest Canadian parties. The Liberal Party appears particularly sensitive to its historic identification with a "free trade" position.

Thus, it is characteristic of older leaders of that party to favour "freer" rather than "free" trade, while many younger leaders of the party, especially from Toronto, identify substantial moves toward free trade with what is labelled "continentalism." The attitudes of this group seem about identical with those of the "Canada First" movement of the 1870s, of which Professor Frank Underhill said the following:

> " . . . it was easy for them to identify the special interests of Toronto with the general interests of the nation as a whole. Their movement, after all, represented only the rhetoric of nationalism; they had not thought their way through the conditions which limit and determine any definition of the national interest. In the final analysis the Canada First movement was only a sectional movement clothing itself in the impressive garments of nationalism."6/

What is striking is any young Canadians today should still have so little confidence in the ability of their country (and especially of Ontario) to participate and compete on equal terms in the continental or world economy. Part of the problem is their preoccupation with the extent of foreign, especially American, ownership of Canadian industry. As already suggested, they fail to appreciate the degree to which trade barriers have both promoted foreign ownership and hindered the ability of subsidiary firms to use their Canadian facilities effectively. What these people should be doing instead of floundering in uncomfortable confusion over the problems posed by foreign ownership is to build upon a free trade foundation a set of domestic policies to ensure that both foreign-controlled and domestic enterprises exploit their full potential for specialized productive activity. For the Liberal Party, the development of a program of this sort is not merely economically advantageous, but of considerable importance in restoring political support in the western provinces, where they have been unsuccessful in recent years and where local political leaders have been most harsh in their criticism of economic nationalists.

Some of the more pragmatic politicians of the other parties may well pre-empt a liberal trade policy. They too are coming to appreciate the economic importance of trade to the process of ensuring sound economic growth, and they may be less constrained by previous positions. Although the Conservatives were the avowed protectionists of the nineteenth century, their leaders frequently demonstrated a willingness to explore reciprocity with the United States and only occasionally, as in 1911, took up a relatively clear position against it. In recent years, the leaders of the Conservative Party have been from the western and Atlantic provinces, and could be expected to take a favourable view of the role of a liberal trade policy in achieving national objectives. The present Conservative leader, Roberd Stanfield, displays both an interest in economic policies and a willingness to employ economic advice in a pragmatic way. Whether he would be likely to adopt a bold program recognizing the contribution that trade policy can make to Canadian productivity and sound and sustainable economic growth cannot as yet be ascertained.

The New Democratic Party has lately played down its propensity to economic nationalism, largely as a result of the efforts of thoughtful members of the parliamentary group to study the structure and performance problems of Canadian industry.

On the domestic political scene one may, I think, conclude that the economic and political potential for a bold trade policy is appearing on the scene. There is arising a common assessment among those who have done empirical studies on Canada's industrial economy (in the universities and in government service), among the leaders of the business community and a number of the younger political leaders, and among a few economically sophisticated newspapermen. The realization lag among others arises out of attachment to traditional policies and institutions, and fear of the consequences of change, etc. An inordinate political influence has been exercised by those businesses which lack managerial confidence to face the new challenge, in part because they may be concerned over the ability of government to comprehend and provide for the needs of transition. In other cases the opposition arises out of a simple fear of loss of profit currently derived under circumstances of comfortable protection. But these comments only serve to underline the breakdown in the foundation of the old alignment of political forces respecting trade policies and the opportunity for political leadership which now exists.

IV The Role of Trade Policy in Canada's International Political Role

On the international political scene, trade policies have always been a very important aspect of Canada's stance, if only because Canada's role among the trading nations is relatively greater than her influence in other spheres, such as the military. Much can be said, and has been said, about Canada's past role in the U.N. and NATO, its direct influence in Washington and London, and so forth. At the risk of oversimplification, Canada's political position could be summarized as follows: Canada is a North American country with many interests in common with the United States, but with a determination, wherever necessary, to promote different (and presumably more effective) means to the achievement of these ends.7/ For example:

1. Canada, like the United States, opposes the spread of Communist governments by invasion or subversion of popular governments, but may well differ on what constitutes "popular" government and therefore as to what constitutes subversion or the appropriate means of dealing with it. It is sometimes said that Canada's attitude to the Soviet Union and China has been influenced by the importance of these countries as markets for Canadian wheat in recent years. Such influences may to a degree be present, but I think that it should also be said that Canadians have never impressed with the argument that her exports of foodstuffs are likely to contribute to the strengthening of the strategic position of nations like the USSR and China. We have also held a somewhat less monolithic conception of the Communist world than that which has from time to time been held in Washington. Except for Viet Nam, however, Washington and Ottawa views of the nature of the Communist forces and of policies needed to deal with them do not appear at present to differ greatly.

2. Canada and the United States have a common interest in

maintaining the security system of the North Atlantic countries, though there are differences of opinion, particularly within Canada, as to just what the Canadian role should be. There is also a good deal more scepticism in Canada about Washington's policy of promoting British entry into the European Common Market, insofar as this is regarded as likely to contribute to the strengthening of the North Atlantic relationship. Canadians are more prone to question the extent to which Britain can be expected to influence Europe's role in the world as a member of the EEC, particularly if the terms are as stiff as is now implied in Paris. There is also concern about the economic damage which might be done while Britain is left at the door awaiting entry.

3. Canada and the United States have an almost identical view on the need for cooperation among all industrially advanced states, and the particular importance of providing for the means by which Japan, as the most important of the non-Atlantic countries in this category, can be incorporated in various institutional arrangements. In the past decade, this concern has been reflected in the support by North America for full Japanese participation in GATT and the OECD.

4. Canada and the United States have a very similar concern for the problems of development in the world. Canada, like the United States, has never been a colonial power in the traditional sense, but as an ex-member of the British Empire, Canada has been somewhat more familiar with the colonial record and a little less prone than the United States to oversimplified critical views of colonialism. More important for the present day, Canada's relationships with the developing world are complicated by the legacy of the British imperial relation -- the special concern for the West Indies and Columbo Plan countries being the most notable instances. (Canadian interests in the developing world have been further complicated by the development challenges in both ex-British and ex-French countries in Africa.) Among the developing countries, the United States has only one traditional relationship -- that with Latin America.

The role of trade policy may serve all the foregoing political interests. It can be a feature of east-west <u>Rapproche</u>

ment, a means of providing Britain an alternative to EEC membership and of similar opportunities for Japan, and a vital aspect of development strategy. It is the last which is probably of greatest and most urgent importance. Unlike most European governments, Canada and the United States today have a direct interest in all three of the major continental sectors of the developing world, and are faced with the need to bring about a measure of joint action if the economic development needs of all these areas are to be met. To date, however, such action occurs only in the established U.N. institutions, and in the Development Assistance Committee of the OECD. None of these arrangements has dealt adequately with trade matters and aggregate foreign aid has been on the decline in relative terms. Commodity agreements have played a significant role in a limited range of the trade in raw materials, but as the UNCTAD documents and other studies since 1964 have stressed, these have not succeeded in stabilizing income from many primary industries. And the structure of trade barriers continues to impose high effective obstacles to manufactured exports from the developing countries, and thus to deter the expansion of such exports.

Canada and the United States, even more than European countries, were unprepared to respond to the UNCTAD demands of 1964. Like other GATT members, they were preoccupied with the Kennedy Round (and some say did not even make an effective public relations effort in support of the unilateral extension of Kennedy Round concessions offered by GATT members to the developing countries). Unlike the Europeans, they could not point to existing preference systems and, in the case of Britain, offer to generalize the application of existing preferences.

Since the 1964 UNCTAD meeting, certain trends have developed, though none with sufficient clarity as to inspire much confidence in their continuity. It is possible that African countries, including former British colonies, may follow the lead of Nigeria in working out modified forms of association with the EEC as well as to maintain, or perhaps even enlarge, regional groupings among themselves. These problems of productive potential do not as yet appear to be so closely related to market access as to require any more general arrangements. Latin American countries have agreed to establish a free trade area. If this is carried forward, it may be possible for the United States to offer temporary unilateral concessions (or preferences) to Latin America, though this will depend on estimates of the supply elasticities of Latin American producers and of the anticipated impact on the United States. As the Latin American market develops, Canada may find it increasingly difficult to avoid participating in a western hemisphere trading relationship, though the most immediate possibility for Canada lies in a much more modest arrangement including only the Commonwealth Caribbean.

Whatever the possibilities in Latin America and Africa, the problems of Asian development remain the most challenging. The massive capital requirements and the foreign trade implications of specialized manufacturing suggest that joint action will be essential to a breakthrough to higher per capita incomes in this area. One of the reservations that may be expressed about British entry into Europe is the possible withdrawal of access to the British market for exports from major Asian Commonwealth members such as India and Pakistan. If these countries are to be assisted in any substantial way, cooperation among the United States, the other countries of the Pacific area, and the USSR may be required. China may provide the needed challenge to explore the possibilities of a common development strategy, though at present the Viet Nam war appears virtually to eliminate the prospect for such cooperation.

As already indicated, Canada has a traditional interest in the evolution of more effective development strategy for Asia though Canada can itself provide only modest aid, when this is considered in relation to the needs of this area. Thus only as a party to larger development schemes is Canada's role likely to be significant.

Canadian interests have been discussed in relation to those of the United States. Some of the distinctive features of Canada's attitudes and approaches to policy have been mentioned. Perhaps the most essential point with which to conclude this section of the paper is that Canadian governments (and the Canadian people) wish to maintain scope for policies which express a distinctive role in world affairs. This is not to be different merely for the sake of being different, but rather because of a belief that Canada may serve its own interests, and perhaps even those of the United States, better by standing ready on occasion to diverge from Washington's views. This is important for trade policy only in one very limited sense. It may be better for Canada to belong to a larger trade group rather than one including only the United States and Canada. A North American free trade area has been suggested as the answer to the essential need for rationalization of Canadian manufacturing industries in the years ahead. In the context of the earlier part of this paper, it seems to me, as it has to other students of Canada's domestic policy problems, that a Canada-U.S. arrangement would indeed help significantly to solve these problems. But it would certainly do little to resolve the problems of other countries unless it were a stage in the kind of joint action required to meet those other greater challenges. Thus, it is in the interest of Canada's own political identity as well as the mutual political concern of both North American countries to promote wider development and trade strategies.

V Trade Policy Options

Any evaluation of the role of trade policy must begin with a review of the status of trade barriers and of the alternative means of removing them.

Following the establishment of the two European communities and the Kennedy Round of GATT negotiations, the level of nominal tariffs between developed countries has been greatly reduced from the levels operative ten years ago. There will soon be free trade in industrial goods within each of the two European groups, the EEC and EFTA, and the external tariffs of these groups and of the United States range for the most part between 5 and 10 percent, after the Kennedy Round reductions have been effected through staged reductions ending in the early 1970s. Countries of the Pacific area, particularly Canada, Australia, and New Zealand, will now be among those few with relatively higher tariffs.

A number of conclusions about future trade policy have been drawn by GATT authorities and by spokesmen for the United States and the EEC:

1. No further general round of tariff reductions under GATT is likely, both because of the time it will take to effect the Kennedy Round concessions and because the remaining tariffs are in many cases not high enough to generate much enthusiasm for the benefits their removal would provide.

2. Since tariffs of the larger trading partners are now low,

any further negotiations would likely involve movements to free trade, and this would be meaningful only if such negotiations were also to include non-tarrif barriers.

3. Since multilateral across-the-board removal of remaining tariffs and non-tarrif barriers is too far reaching to contemplate, a sectoral approach is proposed, with the emphasis on the industrial materials sectors suggested as the first area for exploring the application of such an approach.

It is also generally acknowledged that the EEC will not b much interested in pressing ahead with this or any other GATT neg tiation for several years. At this point, the common external tarif and common agricultural policy at present represent the main symb of the Community's economic identity, and much of its substance.

Now it is quite clear that the above conclusions concerning GATT are not nearly so relevant for Canada, and perhaps not for other Pacific countries, as they are for the EEC and the United States (a fact which has not deterred some Canadian spokesmen from echoing them). There can be little doubt that Canada could benefit from free trade in industrial raw materials, but in fact many of her raw material exports already enjoy almost free access to important markets. And for other similar products, such as industrial chemicals, sectoral free trade could leave Canadian industry with significant negative effective protection unless materials and equipment used by the industry were also subject to sectoral free trade. If all sectors except consumer goods were incorporated into sectoral free trade, the effective protection of such industries would be increased, an outcome which, as past Canadian experience suggests, could merely accentuate the present inefficient structuring of industry. Canada would be far better off economically with across-the-board free trade, assuming an appropriate transition period and adjustment policies.

Before discussing the relative merits of any particular free trade areas, it should be noted that there is at present an institutional drag on the so-called "regional" approach to trade liberalization. GATT spokesmen and supporters have openly opposed most efforts to dismantle trade barriers on anything but a multilateral basis, even though the General Agreement itself provides for such approaches in Article 24. I question whether this opposition is wise in the present circumstances, when by the admission of most of those same GATT spokesmen the traditional multilateral techniques may not be applicable in the near future. Insistence upon the traditional method may bring a frustration which could leave the field to much more specific approaches to solution of the trade problems of individual countries, or could even permit backsliding into protectionism in the absence of effective initiatives. No one can assume that free trade arrangements on a regional basis can always be as practical as the EEC or EFTA, but neither should one close off promising regional approaches to multilateral objectives. Both on the basis of geographic proximity (the traditional concept of a region) and on grounds of stage of economic development, one can conceive of groupings of countries which could move toward a common and liberal commercial policy (in accordance with Article 24) more quickly than other countries occupying a smaller or less economically advanced region or group. If at the same time such countries have as their aim a cumulative approach to the multilateral abandonment of artificial trade barriers, regional groupings may well serve to sustain the momentum of the processes initiated under GATT in the past. Regionalism has contributed to security in the North Atlantic, to the rationalization of aid and development programs, and in Europe and elsewhere to trade liberalization and payments equilibria. Yet there is danger that in some quarters constructive proposals for regional approaches may not get the consideration they deserve, and that this neglect will occur because of a greater concern with institutional prerogatives than with the principles and aims to be served.

VI Pacific Free Trade -- A Canadian View

We come then to prospective trade policies of the Pacific area countries, and to the question of what sort of free trade arrangement might be adapted to the needs of all these countries. Do they really constitute a region? What do they have in common other than an interest in use of the Pacific ocean as a highway for trade? What of the other interests of these same countries?

While I can speak with some confidence only about the attitudes and interests of the North American countries, it is, I think, very evident that the Pacific area is not really a region; it is a hemisphere or a little more. Clearly the most important common interests of the five Pacific rim countries arise out of the fact that they are all industrially developed, that each has an important stake in international trade (though for the United States the stake is more political than economic), and that none of them is now a member of one or other of the regional European groupings which include all other industrially advanced countries. Having established this common ground, it must at once be admitted that many other interests diverge widely. In the narrower regional sense, there are three regions involved, one large -- North America, one medium sized -- Japan, and the other small -- Australia and New Zealand. This obvious distinction is brought out only because it is undoubtedly the source of many of the differences in interest. Certainly Canada's approach, as already argued, relates largely to the unique nature of the Canada-U.S. relationship. The only other common interest is the need for joint action on behalf of the developing countries of this same region. Thus a free trade association must be explored for those varied benefits it may offer the advanced countries of this region and for the opportunity it may provide for a common and coordinated answer to the challenge of development in southeast Asian and Latin America.

From the Canadian viewpoint, and for reasons already spelled out at some length, a free trade association among these countries would serve several useful purposes:

1. It would enable the kind of move to free trade in industrial products which would help Canadian industry to rationalize its pattern of production and trade in specialized manufactures, as well as to maintain the traditional exports of foodstuffs and industrial raw materials.

2. In particular because a free trade arrangement embodies a clear aim to achieve free flow of goods among its members, it should be easier in the context of such an arrangement to work out means for guaranteeing that non-tariff barriers will be eliminated or controlled. The association could not be established unless this were achieved to the satisfaction of the member countries, and it is difficult to conceive of a really satisfactory alternative context for an attack upon non-tariff barriers.

3. Because the free trade area approach, in its recent manifestations, has incorporated arrangements for the transition period, this approach to trade liberalization assists

member countries in adapting to expected competitive challenges. Such transition periods are, of course, possible under the traditional multilateral approach also, as evident in the Kennedy Round arrangements. But in a smaller regional group it might be possible to take fuller account of the differences in extent of adjustment required by allowing transitional periods of greater length for the smaller members, in this case Canada, Australia, and New Zealand.

4. A free trade area, by its nature, permits each member to adopt its own commercial policy towards non members. I believe this feature would also serve the purpose of the Pacific area countries. The three subsections of the Pacific group have particular relationships which they do not share with the others. So far as Canada is concerned, the most obvious examples are the preferences exchanged with the West Indies and Britain, and a possible new relation with Latin America in which Canada, as well as the United States, could become involved. Of course, the relations between developed countries and the less developed nations could, as suggested, become a topic for common action by the Pacific area countries. The new opportunities for trade and economic strength in the Pacific area might make it possible to provide free access to all five members for the exports from all or most of the developing countries in this region. In any case, the flexibility of the external commercial policy of a free trade group (as opposed to a customs union) would make it possible to adopt a different pace of liberalization respecting the various developing areas, perhaps in accordance with the different stages of economic development. A poorer country, such as Indonesia, might be afforded free access immediately, while other more advanced regions, such as Formosa, must be expected to offer reciprocal concessions in exchange for those provided by the full members of the Pacific group.

The free trade area approach to Pacific trade relationships will thus accommodate many of the needs of this area. It does, however, present certain problems: I will concentrate upon two of these. One concerns its apparent exclusiveness. The other arises out of certain distinctive institutional features of the member states which pose problems for the harmonization of commercial practices.

It is clear that a Pacific trade grouping, even though it would in any case include all developed countries which are not already members of one of the European communities, should avoid exclusiveness on principle. In the first place, it should be possible at some stage to generalize trade liberalization by a reciprocal dismantling of barriers with the EEC and with members of EFTA. Indeed, if Britain is to be excluded indefinitely from the EEC, this could occur by EFTA and the Pacific group joining together, followed eventually by EEC membership in a general trading association of developed states. These possibilities suggest that it might be best from the beginning to establish a general free trade association of which the Pacific countries could be charter members, but which could be open to membership on a reciprocal basis to all developed countries.

The remaining trade relationships to be worked out would include those with the USSR and Eastern Europe, and those with the developing countries, especially the large continental Asian countries -- India, Pakistan, and eventually China. These problems may well be interrelated. The development of a basis for trade between advanced countries of the non-Communist world and the USSR and its Eastern European associates is gradually being worked out under GATT auspices. It seems likely that it will eventually become possible for all these countries to associate with GATT by a consistent set of rules which will enable an expanded flow of trade with a minimum degree of discrimination.

But another crucial question must also be resolved -- how far and by what means will the USSR and the countries of Eastern Europe participate in solving the development problem? Clearly, the area of greatest importance is south Asia. The size of the development problem there is enormous, and the political challenge posed by China affects both Soviet and U.S. interests. It seems improbable that adequate aid resources will be forthcoming and that adequate scope will be provided for the exports of the large Asian countries unless the United States and USSR can cooperate to this end. The Pacific area countries will have an opportunity to work out development techniques, and through their collective action may also be able to promote, through GATT and the OECD, a joint development program in south Asia. Unless this can be done, there is danger that that region could come increasingly under the influence of Chinese Communism.

Thus the Pacific free trade group (better named the general free trade association) might become the means both of preventing existing regional arrangements from becoming restrictive and of achieving effective development strategies.

The success of a free trade grouping in which both Japan and the North American countries are full members would also appear to depend on the resolution of a problem of harmonizing what have been called, in the EEC or EFTA, "the rules of competiton." The constitution of a free trade association is normally less explicit about such matters than is that governing a customs union or common market. In the case of the European Free Trade Association, the members agree to consult if differences among the domestic practices of members are likely to lead to frustration of the aims of the Association. There have been committees to consider differences in the treatment of restrictive practices and in the rules governing the establishment of foreign enterprise in EFTA, but the differences have not to date required the adoption of additional conventions. Differences between the domestic practices of Japan and the United States or Canada would appear to present more serious problems. For example, both Canada and the United States are federal countries and it is possible for provincial or state governments to subsidize or protect certain activities even when federal commercial policy is liberal. According to North American sources, the operation of Japanese trading institutions can have similar effects, affecting both the ability of foreign manufacturers to compete with domestic Japanese producers and the choice among otherwise highly competitive foreign sources for imports. Now it is customary in the context of traditional trade negotiations to treat the practices and institutions I have just cited as purely domestic matters. I do not believe it would be possible to inspire confidence in the favourable economic consequences of a free trade association involving the Pacific countries unless these countries recognize the need to adapt any domestic policies which are likely to interfere in a major way with the benefits of specialization under free trade.

One of the most important aspects of this question relates to the role of foreign-owned enterprises. Canada and Japan have adopted different approaches. There is no time to go into this complex question, but on the basis of Canadian experience, I think it can be said that the participation of international enterprises can be an important means of achieving more equal competitive conditions within a free trade zone. I do not mean by this that no form of control or equity is permissible in such a grouping. In any such group involving the United States, the ownership arrangements are likely to be asymmetrical, and other participants might be excused for introducing information-disclosure requirements and guidelines to ensure that foreign subsidiaries will respond to the legitimate and economically-justifiable interests of the host country. But if control of foreign capital goes much further than this, it may fortify, or may seem to fortify, trading practices which are inimical to the purposes of the free trade area.

Much is said now about the importance of non-tariff barriers. The issue is often overstated, whereas the reality relates to a comparatively few important practices. Insofar as there is substance in this issue, however, it seems to me likely that it can be handled only in the context of a commitment to comprehensive free trade at least on a regional basis. If nations reserve the right to maintain tariffs and other conventional barriers, are they likely to be willing to accommodate the complaints of foreign exporters against any substantial interferences with trade flows which arise out of more purely domestic policies? Thus the free trade area probably offers one of the most promising vehicles for making progress in reducing really significant non-tariff barriers. But it is nevertheless a difficult task. In contemplating a free trade association, the principal internal challenge to the Pacific countries may be not in the ability of their various industries to adapt to competitive challenges they may pose for one another, but rather in the necessity of achieving a sufficiently common set of rules governing competition. In this way only can individual enterprises be assured of the prospect of equal competitive opportunities in the markets of other member countries.

Footnotes

1/ These statistics are derived from a forthcoming book by Professor Bruce Wilkinson, Trends in Canadian Trade.

2/ H. E. English, Industrial Structure in Canada's International Competitive Position, Private Planning Association of Canada, 1964 -- especially Chapters 2 and 3.

3/ H. E. English, "An Essay on the Nature and Efficiency of Canadian Industrial Structure", in a forthcoming publication of Duke University.

4/ N. H. Lithwick, Prices, Productivity, and Canada's Competitive Position, Private Planning Association of Canada, 1967.

5/ Ronald J. Wonnacott and Paul Wonnacott, Free Trade Between the United States and Canada: The Potential Economic Effects, Harvard University Press, 1967.

6/ Frank H. Underhill, In Search of Canadian Liberalism, Macmillan, 1961, pp. 174-5.

7/ H. E. English, Transatlantic Economic Community, Canadian Perspectives on the Role of Trade Policy in World Affairs, in series Canada and the Atlantic Economy, Private Planning Association of Canada, to be released, 1968.

Chapter 2 CANADIAN TRADE, THE KENNEDY ROUND AND A PACIFIC FREE TRADE AREA

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I Introduction

The major purpose of this paper is to examine the economic implications for Canadian industry and the Canadian balance of international payments of free trade among the developed nations of the Pacific Region. Both static and dynamic effects of free trade on industrial output and the balance of payments will be considered. Ignored, however, are the welfare implications of trade liberalization.

Since the problems which Canada may face in the event of free trade are largely a function of the present structure of Canadian trade, we commence with a brief discussion of the main features of current Canadian trade patterns and trends. Then the existing trade structure is adjusted for the Kennedy Round of tariff negotiations to arrive at a trade matrix for use in assessing the economic implications of a Pacific Free Trade Agreement. Where somewhat arbitrary decisions are necessary when estimating both the Kennedy Round effects and the static effects of a PFTA, they are made so as to provide the most unfavorable estimates of the resulting Canadian trade patterns. This approach will give us a maximum estimate of the extent to which positive, dynamic changes will have to offset these static effects if Canada is to avoid a depreciation, substantial downward pressure on wages, and/or greatly increased capital inflows.[1] We shall then examine the economic feasibility of these required dynamic changes in the light of existing theoretical and empirical knowledge about their attainability. The analysis is highly aggregative, but in that the findings are

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[1]This is not to imply that these types of adjustment might still not be economically preferable to existing tariff and non-tariff barriers to trade. But if there is reason to believe that the move to free trade can be made without such consequences, the Canadian political objections to free trade becoming a reality will accordingly be greatly reduced.

largely consistent with other less aggregative studies,[1] it complements these other works.

II Canadian Trade

As with many other small (in terms of population) industrialized nations, foreign trade is of great significance for the Canadian economy. In recent years imports and exports have equalled about 16 and 17 percent of gross national product respectively. Consequently Canada is the world's fifth largest trading nation.

Whether we speak of a Pacific or an Atlantic Free Trade Area, the issues for Canada are much the same. This follows because both proposed free trade areas include the United States, our major trading partner. In 1966, over 70 percent of our total imports were from that country and 60 percent of our exports were destined for it. If only Canadian trade with the developed nations of the Pacific is considered, the U.S. accounts for 96 percent of imports and 92 percent of exports. Although between 1954-56 and 1963-65 a downward trend occurred in the proportion of our imports from and exports to our southern neighbor, this trend was brought to a halt abruptly when the Canada-United States Automobile Pact, which was signed in January of 1965, came into full play. For 1966 the shares of our total merchandise trade with that country were restored to the levels prevailing in 1954-56.[2]

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[1]See particularly R. J. and Paul Wonnacott, <u>Free Trade Between the United States and Canada: The Potential Economic Effects</u> (Cambridge, Mass.: Harvard University Press, 1967; also the series of studies on North Atlantic Free Trade sponsored by the Private Planning Association of Canada forthcoming.)

[2]Exports of road motor vehicles and parts to the United States rose from $230 millions in 1965 to $840 millions in 1966, that is, from 2.6 percent of total merchandise exports to all countries in 1965 to 8.1 percent in 1966. Imports of vehicles and parts increased from about $950 millions or 11 percent of total imports from all nations in 1965 to well over $1,400 millions or 15 percent of imports in 1966. These numbers, particularly for vehicle imports, are understated owing to some delay in reporting by customs officials. But they are sufficient to indicate the enormous impact that the automobile agreement has had on the total volume of Canada-U.S. trade.

TABLE (1a)

ORIGIN OF CANADIAN IMPORTS,
1954-56, 1963-65 and 1966,

PERCENTAGES

	1954-56	1963-65	1966
United States	72.9	69.0	72.3
United Kingdom	8.8	7.6	6.5
Japan	.8	2.4	2.6
Germany	1.3	2.3	2.4
Australia-New Zealand	.9	1.0	.8
All Other	15.3	17.7	15.4
	100.0	100.0	100.0
EFTA	9.8	9.5	8.7
EEC	3.4	5.6	5.6
Commonwealth and Preferential	13.0	12.8	10.8
PFTA	74.6	72.4	75.7

Source: B. W. Wilkinson. Canada's International Trade Analysis of Recent Trends and Patterns. (Montreal: Private Planning Association of Canada, 1968) Table 11 and 15; and Trade of Canada.

TABLE (1b)

DESTINATIONS OF CANADIAN EXPORTS
1954-56, 1963-65 and 1966

PERCENTAGES

	1954-56	1963-65	1966
United States	59.5	55.0	59.9
United Kingdom	17.3	14.4	11.2
Japan	2.4	4.0	3.9
Germany	2.5	2.4	1.8
Australia-New Zealand	1.6	2.1	1.6
U.S.S.R. and China	.3	4.3	5.0
All Other	16.4	17.8	16.6
Total	100.0	100.0	100.0
EFTA	19.5	16.4	13.2
EEC	6.7	7.1	6.3
Commonwealth and Preferential	22.5	20.4	16.6
PFTA	63.5	61.1	65.4

Source: Same as Table (1a).

This and other changes and trends in the country composition of Canadian trade are summarized in Tables la and lb. The success of Japan in competing for the Canadian market is evident from the fact that in spite of the tremendous boost given to Canada-U.S. trade by the automobile agreement, the Japanese share of Canadian imports continued to rise in 1966. Between 1964 and 1966 Canadian imports from Japan expanded 45 percent— compared with only a 20 percent rise in Canadian exports to that country. The share of the United Kingdom in Canada's imports has continued its long run decline, although it remains our country's second largest export market and source of imports. The impressive increase in Canadian exports to Russia and Communist China are the consequence of massive wheat sales to these two nations.

The commodity composition of Canadian trade flows is of much relevance in any deliberations on free trade that we may undertake. In recent years manufacture commodities have comprised 82 percent of the nation's imports but only 64 percent of its exports. (Table 2) The definition of manufactures employed in arriving at these percentages is very broad however. It includes many commodities that are not far removed from their crude states--lumber, woodpulp, flour, frozen fish, newsprint, and semi-processed metals such as aluminum, copper and nickel alloys, and primary iron and steel. If we confine ourselves to the more sophisticated manufactures such as machinery, transportation and communication equipment, tools and miscellaneous equipment, scientific apparatus and consumer durables and semi-durables, the comparison of import and export composition is much more striking. These products total 54 percent of imports but little more than 17 percent of exports.

Canadian exports, then, are largely of those commodities that are growing relatively slowly in world trade--crude and fabricated materials. But imports are largely highly processed manufactured goods, in which world trade is expanding more rapidly than for any other group.

Given the concentration of Canadian exports in products enjoying less than average growth in world trade it is not surprising that from the early 1950's until 1964-66 this nation's exports have been expanding less rapidly (5.7 percent annually) than world trade (excluding intra-block EEC trade) has expanded (6.6 percent). Another factor contributing to this slug-

TABLE 2

CANADA'S IMPORTS AND EXPORTS

BY STAGES OF FABRICATION[1]

1954-56 and 1963-65

(Percentages based on current dollars)

Stages of Fabrication	Imports		Exports	
	1954-56	1963-65	1954-56	1963-65
Crude Materials	20.9	18.3	31.5	36.1
Manufactured Goods	79.1	81.6	67.4	64.0
Fabricated Materials[2]	29.2	27.3	56.8	46.6
End Products	49.9	54.3	11.6	17.4
	100.0	100.0	100.0	100.0

Source: B. W. Wilkinson, op. cit.

Notes:

1. Dominion Bureau of Statistics definitions
2. Roughly comparable to what are often referred to as industrial materials in many comparisons based on S.I.T.C. classifications.

gish growth of Canadian shipments abroad has been the reliance upon the United Kingdom and the United States as markets. Both nations have been growing more slowly than many developed nations--at least until the last few years when American expansion has frequently surpassed that of most western European countries.

There has been some relative improvement in the Canadian export performance since the early 1960's, however. The large wheat sales to Russia and Communist China, the development of the Labrador iron ore deposits for shipment to United States markets, and the expansion of the U.S. market for Canadian petroleum and natural gas have all contributed to this improvement. (Notice though, that they have also increased Canadian dependence upon crude materials exports.) The devaluation of 1961-62 preceeded by a period of cost-cutting necessitated by unemployment and an overvalued currency in the late 1950's gave new life to Canadian secondary (or highly sophisticated) manufacturing exports. The more rapid American economic growth, the Canada-United States Defense Production Sharing Program, the auto pact referred to earlier, export insurance and other government measures to stimulate exports (although modest by comparison with the role of governments in promoting exports in some other developed nations) have been of some assistance as well.

In spite of recent improvements, however, future merchandise shipments abroad are expected to grow more slowly than imports. The Economic Council of Canada has forecast the average annual change in the volume of exports to be 7.7 percent for 1966-1970 whereas the comparable number for imports was estimated at 8.4 percent.[1] The great reliance by Canada upon exports of products growing more slowly in world trade than most of the products we import is the major explanation for these expected trends. But the inflation of the last two or three years, which has badly eroded the advantage gained by the devaluation in 1961-62 should not be overlooked as a contributing factor. In 1970, then, the surplus on merchandise account which Canada has enjoyed since 1961 is expected to be no more than 200 millions.

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[1] Fourth Annual Review: The Canadian Economy from the 1960's to the 1970's (Ottawa: Queen's Printer, 1967), pp.122-123.

This reduced surplus, will be accompanied by a growing deficit on non-merchandise account. In 1966, this decifit totalled $1.4 billions of which nearly $900 millions were net interest and dividend payments on foreign investments in Canada, and a further $250 millions were for other transactions frequently related to foreign investment such as payments from Canadian subsidiaries or branches to foreign parents for production and distribution rights, royalties, research, advertising management, engineering and consulting services. The Economic Council place the total non-merchandise deficit in 1970 at $1.9 billions. The net deficit on current account, and hence the required capital inflow or reduction in reserves, will therefore be about $1.7 billions. This is probably a minimum for it implies that total domestic (personal and government) savings in that year will have to rise to 22.3 percent of GNP compared with 19.9 percent in 1966 and 18.7 percent in 1963.[1] How this increased savings ratio will be brought about is not altogether clear.

It is therefore evident, even from these cursory remarks, that any moves to free trade that might greatly enlarge the need for capital inflows or necessitate a depreciation of the Canadian dollar must be examined carefully.

III <u>The Kennedy Round</u>

The tariff reductions agreed to by Canada in the Kennedy Round of negotiations relate to about $2.5 billions or 25 percent of Canadian imports in 1966, that is, to about 50 percent of dutiable imports.[2] An attempt was also made by the negotiators to simplify the structure of the Canadian tariff so that there would be greater uniformity of rates among different products at each level of processing. Also, some smoothing down of higher rates in the tariff took place, so that apart from a few sectors such as textiles and footwear, duty rates greater than 20 percent ad valorem will now be exceptional.

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[1]Based upon computations from <u>ibid.</u>, Table 5.6. p. 115 and Table 5.4 p. 111.

[2]The average duty on dutiable imports in 1965 was about 16.5%, on total imports, 8.5%, and on all manufactured imports, about 11%.

More than $2 billions or over 20 percent of Canadian exports in 1966 will be affected by the tariff reductions of our trading partners, primarily the United States. In addition, the 21 percent per bushel increase in the minimum and maximum price for No. 1 Northern wheat will mean an increase of about 10 percent in the average price per bushel of Canadian wheat exports (which, at present amount to $1 billion annually).

It is difficult to know what the effects of these tariff decreases will be upon Canadian trade flows. On the one hand, government officials laud them as offering immense opportunities for Canadian manufacturers to attain economies of scale concomitantly with increased penetration of the gigantic U.S. market. Manufacturers, on the other hand are much more cautious in their predictions about the eventual impact of the changes.

For my purposes it is useful to take a conservative view. The traditional, static elasticities approach to estimating the adjustments in trade patterns that may occur will therefore be followed. The possibilities of new economies of scale being attained by Canadian industry as a consequence of lower U.S. tariffs will be ignored at this stage in the discussion. Consequently the results will tend to indicate a less favorable position for Canadian trade than might well be true. This will in turn tend to increase the size of the estimated deficit resulting from the static effects of a Pacific Free Trade Agreement.

Also ignored in the present approach are the changes in the effective protection of products arising from alterations in tariffs on inputs. Although effective tariffs are presently being calculated for about 135 Canadian manufacturing industries,[1] these estimates were not available for use in the preparation of this paper. Therefore, we have had to be content with considering only the impact of nominal tariff changes.

Total Canadian trade flows for 1965 were used as the base when computing the static Kennedy Round effects. An argument might be made for the exclusion of agricultural commodities and fuels because trade in these products is often sub-

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[1]See J. R. Melvin and B. W. Wilkinson, Effective Protection in the Canadian Economy, forthcoming.

ject to non-tariff restrictions.[1] However, trade in many manufactured commodities is also influenced greatly by a wide variety of non-tariff barriers ranging from quotas to more surreptitious procedures such as buy-domestic policies, and subsidies of many types. Consequently, all merchandise has been included rather than somewhat arbitrarily excluding particular groups. Quantitative estimates of these other forces will not be attempted, although a few qualitative remarks will be made about non-tariff matters later in this paper.

One additional explanatory remark is necessary regarding the trade flows included in our estimates of the Kennedy Round effects. It is assumed that Canadian trade with Australia and New Zealand will not be altered materially by the tariff changes. The supposition is that the stimulus to trade between Canada and these nations from the tariff reductions will be offset by the reduced margins of British preference that each country enjoys in the other's markets. Although this presumption undoubtedly does some violence to reality, the extent of the error arising therefrom will be tiny compared to the overall magnitude of Canadian exports and imports involved in trade with these nations, the United States and Japan.

The formula employed for the estimates is a common one;

$$dM = E_m \cdot M. \frac{t-t'}{1+t}$$

where: dM = the change in imports,
E_m = the importing country's relative price elasticity of demand for imports,
t = the pre-Kennedy ad valorem tariff rate,
t' = the post-Kennedy ad valorem tariff rate.

This formula assumes that the importing nation maintains constant prices for its import-competing products and that prices of imports are lowered by the full amount of the tariff reduction. This latter assumption also implies that the exporting

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[1] Eg. see B. Balassa and M. E. Kreinin, "Trade Liberalization Under the "Kennedy Round": The Static Effects," Review of Economics and Statistics, 49 (May, 1967), p. 125.

nation has perfectly elastic export supplies. This would seem to be a reasonable supposition for exports from the United States since such commodity flows in general comprise only a small percent of total American output. Increased supplies therefore should be forthcoming without significant price increases.[1] Even for most Canadian manufacturing industries exports are but a small proportion of total output. The exceptions are few: pulp and paper, primary metal, wood and wood products, and some food and beverage industries.[2] But even for these industries there is little reason to hypothesize significant price increases as exports expand. First, foreign tariffs on these goods are already low, so that exports will not be stimulated very much by the Kennedy Round tariff reductions. Second, labour force growth rates in Canada have been and are anticipated to continue high in relation to both recent and anticipated growth rates in other industrialized countries.[3] Consequently, there is little reason to expect any substantial wage increases being necessary in the export sectors in order to attract labour from other sectors of the economy. New labour force entrants will likely be adequate to satisfy increased demands for labour. Finally, to anticipate our results, the tariff reductions reduce the present Canadian surplus on merchandise account, and would therefore tend to displace labour rather than increase the total demand for it. Hence, there might be even downward pressure on wage rates. In short, then, the assumption that Canadian prices of manufactured exports will remain unaltered by the

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[1]For a more detailed discussion of this type of assumption see Balassa and Kreinin op.cit; also M. Kreinin, Alternative Commercial Policies - Their Effect on the American Economy. (Michigan: MSU International Business and Economic Studies, 1967).

[2]As Appendix Table 3 indicates, these are the only industries where exports are greater than 10% of total output.

[3]See Economic Council of Canada, Fourth Annual Review: The Canadian Economy From the 1960's to the 1970's. (Ottawa: Queen's Printer, 1967), ch. 3.

Kennedy Round tariff reductions seems a good first approximation.[1]

Although Canadian exports of non-manufactured goods often account for a substantial portion of total output, the last three reasons cited above may also be introduced to support the assumption of no Canadian price increases in these commodities either.[2]

Japanese exports total between 12 and 14 percent of gross national product, so that there may be cause to think that the expansion of exports made possible by the Kennedy Round might lead to some rise in Japanese export prices. However, we assume this possibility aside--an assumption which is in line with our goal of providing a maximum estimate of the expansion in Canadian imports relative to exports.

The import price elasticities used are of necessity somewhat arbitrary. Balassa and Kreinin[3] relay on Ball and Marwah's[4] estimates for the United States and increase them by one standard error. Their estimates for Canada and

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[1]If the recent record is any indication, Canadian export prices may increase, but these must be attributed to domestic problems not directly related to the Kennedy Round tariff reductions.

[2]We can ignore at this point the increased wheat prices as tariff reductions in wheat did not occur.

[3]See Review of Econ. and Stat., 49 (May, 1967, pp. 126-128) for their reasoning.

[4]"The U.S. Demand for Imports, 1948-1958", Rev. of Econ. and Stat., 44 (November, 1962), pp. 394-401.

Japan were set at one-half and three quarters of the American elasticities respectively. This example has been followed here.[1, 2]

The broad commodity classification employed is similar to that in the Ball and Marwah study. Placement of individual SITC groups into these classes, however, has been carried out to correspond with Dominion Bureau of Statistics industrial classifications and other recent work that has been done in Canada on trade and tariffs.[3] The main classes distinguished and the relevant price elasticities are as follows:

Commodity Class	Canada	United State	Japan
Crude Foodstuffs and Feed	-.24	-.48	-.36
Crude Materials	-.20	-.39	-.29
Processed Foodstuffs	-1.20	-2.39	-1.79
Primary Manufactures	-.82	-1.63	-1.22
Secondary Manufactures	-2.06	-4.12	-3.09

[1]However, we have corrected for the error in their article, p. 129 which shows the elasticity for semi-finished manufactures by Japan as -1.42 instead of -1.22 as it should if the Ball-Marwah estimate plus one standard error is used as the rule for arriving at the Japanese elasticity.

[2]New computations of price elasticities for Canadian imports from Japan and Japanese imports from Canada are presently being prepared by Professor Keith Hay, but these were not available at the time this paper was prepared.

[3]Eg. B. W. Wilkinson, op. cit.; also J. Melvin and B. W. Wilkinson op. cit.

The SITC groups included in each of these classes is shown in the Appendix of this paper. The term "primary manufactures" is roughly similar to the Ball-Marwah caption: semi-manufactures. In Canadian statistics it refers to those manufactures for which at least 50 percent of the inputs come from the primary sector of the Canadian economy; that is, it consists of manufactures based on Canadian natural resources. Secondary manufactures are essentially sophisticated products such as machinery, transportation and communication equipment, chemicals, and consumer durables and semi-durables.[1]

Separate computations were made for each of the 177 SITC groups in which commodity flows between Canada and United States and Japan were recorded for 1965. In a few situations were a subdivision of 3-digit groups was necessary to reflect the DBS classification of production, 4-digit SITC groups were distinguished.

Adjustments were made in the Canadian and American pre- and post-Kennedy tariff rates to allow for these tariffs being levied f.o.b. rather than c.i.f.[2] U.S. duties on benzenoid chemicals were doubled to reflect the impact of the American Selling Price method of valuation on imports of these goods.[3] Shipments of motor vehicles and parts between Canada and the United States were all assumed to have duty-free pre-Kennedy Round rates even though replacement parts are not included in the automobile agreement.

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[1] The category "processed foodstuffs" could have been easily allocated between primary and secondary manufacturing, but for purposes of applying a separate elasticity estimate, it has been distinguished.

[2] See Frances K. Topping, Comparative Tarrifs and Trade, Vol. 1 (Committee for Economic Development, 1963), p. XIII.

[3]. See Political and Economic Planning, Atlantic Tariffs and Trade (London: George Allen and Unwin, 1962), p. xvi; also H. G. Grubel and H. G. Johnson, "Nominal Tariff Rates and United States Valuation Practices: Two Case Studies", Rev. Econ. and Stat., 49 (May, 1967), pp. 138-142.

Pre- and post-Kennedy Round tariffs were obtained from the tariff schedules of the countries involved and from the July 1, 1967 Department of Trade and Commerce publication, Foreign Trade.[1] For commodities within each of the 177 SITC groups, unweighted averages of tariffs and tariff changes were applied to the commodity movements.

Table 3 summarizes the effects of the Kennedy Round changes upon Canadian trade with United States and Japan.

Care must be taken in interpreting these results, however. Only the static consequences of the tariff reductions have been considered. Recall that the complications arising from tariff changes on inputs, new opportunities for economies of scale that might be grasped by Canadian manufacturing, and the continued presence of non-tariff barriers to trade have all been pushed aside. Also ignored is the possible improvement in the Canadian merchandise trade balance that might arise from the agreed 10 percent higher price for wheat.[2] Specific allowance for these other factors would probably lower the net expansion of the Canadian trade deficit with these countries, but it is unlikely to reverse the direction of the change. It is even less likely when one considers that no allowance has been made for the increase in Canadian imports from the United States and Japan that may well ensue from lowered preferences by the United Kingdom and other Commonwealth or preferential countries outside the proposed PFTA.

The results, in general, are a consequence of the large proportion of crude and semi-processed products in Canadian exports and the low proportion of these same types of products in Canadian imports. Foreign tariffs on them were already low prior to the Kennedy Round and price elasticities are also low, so that the projected increases in exports in most instances were marginal. In contrast, the duty rates and price

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[1](Ottawa: Queen's Printer, 1967).

[2]Assuming that the higher price does not cause an offsetting reduction in the volume of wheat sold.

TABLE 3

STATIC EFFECTS OF KENNEDY ROUND FOR CANADIAN TRADE WITH UNITED STATES AND JAPAN

BASED ON 1965 TRADE FLOWS[1 2]

Trade With United States

Commodity Group	Increase In Exports To U.S.A.		Increase In Imports From U.S.A.		New Trade Balance	Net Change In Trade Balance +Surplus Increased Or Deficit Decreased -Surplus Decreased or Deficit Increased	
	Millions of $	%	Millions of $	%	Millions of $	Millions of $	% of Original Balance
Crude Foodstuffs	1.5	1.3	3.3	1.6	-96.8	-1.8	1.9
Crude Materials	.3	.0[3]	1.8	.3	391.0	-1.0	.2
Processed Foodstuffs	33.0	9.8	8.3	6.1	223.8	+24.7	11.0
Primary Manufacturing	21.5	1.7	7.4	3.3	1784.3	+14.1	.1
Secondary Manufacturing	137.0	10.8	230.1	5.4	-3081.0	-93.1	3.1
Total	193.3	4.1	250.9	4.7	-778.7	-57.6	8.0

Trade With Japan

	Increase In Exports To Japan		Increase In Imports From Japan		New Trade Balance	Net Change In Trade Balance	
	Millions of $	%	Millions of $	%	Millions of $	Millions of $	%
Crude Foodstuffs	.0[3]	-	.0[3]	-	95.2	+.0[3]	.0
Crude Materials	1.9	1.3	.0[3]	-	153.8	+1.9	1.3
Processed Foodstuffs	.4	7.4	.5	8.1	-.4	-.1	33.3
Primary Manufacturing	1.3	7.8	.5	3.8	2.9	+.8	37.2
Secondary Manufacturing	2.5	13.2	11.9	6.4	-176.6	-9.4	5.6
Total	6.1	2.1	13.0	6.2	74.9	-6.9	8.4

TOTAL TRADE WITH U.S.A. AND JAPAN

	Total Increase In Exports		Total Increase In Imports		New Trade Balance	Total Net Change In Trade Balance	
	Millions of $	%	Millions of $	%	Millions of $	Millions of $	%
Crude Foodstuffs	1.5	.7	3.4	1.5	-1.6	-1.9	-
Crude Materials	2.2	.1	1.8	.3	544.8	+ .9	.2
Processed Foodstuffs	33.4	9.7	8.8	5.2	223.4	+24.6	12.4
Primary Manufacturing	22.8	1.1	7.9	3.4	1787.2	+14.9	.8
Secondary Manufacturing	139.5	10.2	242.0	5.5	-3257.6	-102.5	3.3
Total	199.4	4.0	264.0	4.7	-703.8[4]	-64.5	10.1

Source: see Text

Notes:
1. All dollar estimates are in U.S. dollars.
2. Totals may not add due to rounding.
3. Less than $.05 millions or less than .5 per cent.
4. When current trade with Australia and New Zealand is included, this deficit would be decreased to -$596 millions.

elasticities for highly manufactured goods, which form the majority of Canadian imports, are quite high so that Canadian imports will tend to increase substantially owing to tariff decreases.

We now turn to the prime concern of this paper, namely the static and dynamic economic implications for Canada of a Pacific Free Trade Agreement.

IV A Pacific Free Trade Area

The initial part of this section involves an estimate of the static effects of a PFTA using the elasticities approach of the foregoing discussion.

Subsequently, the keystone argument for Canadian participation in a free trade area--the possibility of economies of scale, and hence lower prices, being realized through access to larger foreign markets--will be considered, and an estimate will be made of the percentage decline in Canadian import-competing and export price that would be necessary to eliminate the Canadian deficit on merchandise account resulting from the static effects of free trade.[1] This estimate will then be related to evidence on the extent to which Canadian prices are presently above those of our major trading partner, the United States. Finally, qualitative consideration will be given to other dynamic and not-so-dynamic influences which may affect the outcome of a free trade agreement.

First, a few remarks are necessary regarding the use of an elasticities approach when tariff reductions are as large as those that would be involved in any free trade agreement. Ron Wonnacott has argued[2] that for Canadian secondary manu-

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[1]The alternate possibility that economies of scale might not be realized and that balance of payments adjustment could take place through a depreciation of the Canadian dollar is being disregarded. Of greater interest at this time is how large an average price decrease would have to accrue from a tariff reduction and the attainment of economies of scale to avoid this alternative.

[2]"Canada in an Atlantic Community", Studies in Trade Liberalization, B. Balassa (ed.) (Baltimore: John Hopkins University Press, 1967).

facturing the production cost structure will be changed so radically by the elimination of tariffs on inputs and the rationalization that will be necessary when domestic and foreign tariffs are eliminated that past trade patterns are of little relevance in estimating the consequences of free trade.[1] This is, of course, in part true,[2] but the present approach does not seek to determine the precise new pattern of trade that will result from free trade. This can only be determined by detailed industry studies.[3] Nor is the discussion being limited to static effects. Rather the objective is to provide something approaching a maximum (highly-aggregative) estimate of the adverse effect upon the Canadian merchandise trade balance that might result if a restructuring and rationalization of Canadian industry did not occur. Then, it is domestrated that the lowering of Canadian costs that would be necessary (and largely attainable from the dynamic effects of free trade) if this adverse effect is to be prevented, do not appear unattainable. In short, then, the conclusion reached by this approach is similar to Wonnacott's in that it suggests that providing the necessary rationalization is carried out, Canadian secondary manufacturing can survive and prosper under free trade. Our final conclusion differs somewhat from his, however, in that we emphasize that the location of industry and trade in manufactures depend on much more than relative labour-capital endowments.

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[1]H. Grubel in "Intra-Industry Specialization and the Pattern of Trade", Canadian Journal of Economics and Political Science, 33 (August, 1967) pp. 374-388 takes much the same position, although his concern is more with the influence of product differentiation on trade flows in the event of tariff reductions.

[2]But see B. W. Wilkinson, op. cit., chap. 8, for an alternative line of thought.

[3]Of a type presently being sponsored by the Private Planning Association of Canada. Even these, however, will only give some broad guidelines on the eventual structure of production and pattern of trade that will develop.

(1) The static results of a PFTA. The trade flows and tariff rates upon which the computations are based are those for 1965 adjusted for the Kennedy Round tariff reductions as indicated earlier. The same price elasticities of import demand are used for Canada, United States, and Japan as were used before. Elasticities for Australia and New Zealand are taken to be equal to those for Canada. No allowance is made for the modification in trade patterns which might ensue from the effects of free trade upon the preferential arrangements between Canada, Australia, and New Zealand. Although such modifications may be substantial for particular commodities traded, they would not be large in relation to the total Canadian trade with the PFTA nations. No allowance is made either for the effect of the elimination of the United Kingdom preferences in the Canadian market. These would undoubtedly stimulate some substitution of imports from the United States and Japan for imports from Britain, thus raising the Canadian deficit with PFTA nations.

The changes in trade flows between Canada and each of the developed nations involved are presented in Table 4. Canadian imports would expand nearly $440 millions more than exports. (This deficit is due entirely to the growth of secondary manufactured imports. Canada would gain, on balance, in each of the four other commodity groups.) Such a change would bring the total Canadian merchandise deficit on trade with the developed nations of PFTA to nearly $1,150 millions, and the small surplus on total Canadian merchandise trade with all nations of the world in 1965 would become a deficit of nearly $400 millions.[1]

These results are broadly in line with those from another recent estimate of the impact of free trade upon Canadian imports and exports. Kojima,[2] using pre-Kennedy Round tariff rates, higher elasticities for all the nations involved, a somewhat different classification of commodities and a 1963 trade matrix estimated the Canadian import and export increases to

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[1]And based on these computations, if the Economic Council's projects of total import and export growth rates to 1970 were correct, the total Canadian merchandise deficit in that year would increase to nearly $1 billion.

[2]"A Pacific Economic Community and Asian Developing Countries", Hitotsubashi Journal of Economics,7 (June, 1966), pp. 17-37.

TABLE 4

STATIC EFFECTS OF FREE TRADE ON CANADIAN TRADE WITH THE DEVELOPED NATIONS OF THE PACIFIC AREA, COMPARED WITH CANADIAN POST-KENNEDY ROUND TRADE[1 2]

Trade with United States

Commodity Group	Increase In Exports To U.S.A.		Increase In Imports From U.S.A.		Net Change In Trade Balance With U.S.A.	
	Millions of $	%	Millions of $	%	Millions of $	%
Crude Foodstuffs	1.7	1.5	1.4	.6	.3	-.3
Crude Materials	4.2	.4	1.0	.2	3.2	.3
Processed Foodstuffs	23.3	6.3	9.3	6.4	14.0	6.3
Primary Manufacturing	29.8	1.5	15.3	6.7	14.5	1.3
Secondary Manufacturing	236.9	17.0	693.5	15.5	-456.6	14.8
TOTAL	295.9	6.1	720.5	12.8	-424.6	54.2

Trade With Japan

	Increase In Exports To Japan		Increase In Imports From Japan		Net Change In Trade Balance With Japan	
	Millions of $	%	Millions of $	%	Millions of $	%
Crude Foodstuffs[3]	.0	-	.0	-	.0	-
Crude Materials[3]	1.7	1.1	.0	-	1.7	1.1
Processed Foodstuffs	.3	5.6	.4	6.9	- .1	27.8
Primary Manufacturing	2.4	13.8	1.3	9.2	.9	31.0
Secondary Manufacturing	3.1	14.8	47.3	23.9	-44.2	25.0
TOTAL	7.6	2.6	49.1	22.0	-41.6	-64.1

Trade With Australia

	Increase In Exports To Australia		Increase In Imports From Australia		Net Change In Trade Balance With Australia	
	Millions of $	%	Millions of $	%	Millions of $	%
Crude Foodstuffs[3]	.0	-	.2	2.1	-.2	2.6
Crude Materials[3]	.0	-	.0	-	.0	-
Processed Foodstuffs	.3	10.1	1.0	4.6	-.7	3.8
Primary Manufacturing[3]	1 4	6.9	.0	-	1.4	6.9
Secondary Manufacturing	24.3	32.0	.4	10.9	23.9	33.0
TOTAL	26.1	19.9	1.6	3.7	24.5	27.6

Trade With New Zealand

Commodity Group	Increase In Exports To New Zealand		Increase In Imports From New Zealand		Net Change In Trade Balance With New Zealand	
	Millions of $	%	Millions of $	%	Millions of $	%
Crude Foodstuffs3	.0	-	.0	-	.0	-
Crude Materials3	.0	-	.1	.5	-.1	1.7
Processed Foodstuffs3	.0	-	.2	4.1	-.2	6.9
Primary Manufacturing3	.0	-	.0	-	3.3	-
Secondary Manufacturing3	3.3	16.3	.0	-	3.3	16.3
TOTAL	3.3	10.1	.2	1.6	3.0	15.5

Total Trade With Developed Nations of Pacific

Commodity Group	Total Increase In Exports		Total Increase In Imports		Total Net Change in Trade Balance	
	Millions of $	%	Millions of $	%	Millions of $	%
Crude Foodstuffs	1.7	.8	1.6	.7	.1	-1.0
Crude Materials	5.9	.3	1.1	.2	4.8	.4
Processed Foodstuffs	24.0	6.3	10.8	6.1	13.2	6.5
Primary Manufacturing	33.7	2.5	16.7	6.9	17.0	1.5
Secondary Manufacturing	267.6	17.7	741.2	15.8	-473.6	15.0
TOTAL	332.9	6.3	771.4	13.1	-438.5	73.0

Source: see Text

NOTES
1. All dollar estimates are in U.S. dollars.
2. Totals may not add due to rounding.
3. .0 implies less than $.05 millions

be about $250 millions greater than Table 4 suggests, but the net deficit resulting was less than $50 million larger than our number.[1]

(2) <u>Dynamic effects of a PFTA: Economies of Scale</u>.

The economies of scale idea is a very familiar one. For Canada it is confined largely to secondary manufacturing because many of the raw material producing and primary manufacturing industries have already attained sufficient scale economies to be able to export competitively.[2] The argument is that other nations tariffs on Canadian <u>secondary</u> manufactures (particularly the tariffs of the United States) tend to limit the opportunities for exporting and hence for achieving economies of scale in production, and that the protection afforded by the Canadian tariff provides no incentive for firms in Canada to rationalize and obtain those scale economies which are attainable even within the confines of the Canadian market. The removal of foreign tariffs would provide a larger market for Canadian producers, and the removal of Canadian protection would offer the necessary stimulus to them to modernize and rationalize their production. Lower production costs and hence lower prices and a more internationally competitive secondary manufacturing industry would be the hoped-for outcome.

How much would prices in secondary manufacturing have to decline to eradicate the deficit on merchandise account that might otherwise occur from trade liberalization? The answer

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[1] Also of interest is that Wonnacott used an elasticities approach for only non-agricultural resource products (roughly comparable with crude materials plus primary manufacturing in our classification) and concluded that Canada might gain from an Atlantic free trade agreement in these goods to the extent of about $50 to $100 millions. This gain is somewhat larger than our estimate for the comparable groups, although the difference is not surprising considering that he was concerned with a larger trading block in the Atlantic rather than with Pacific free trade.

[2] In fact exports have often been the means of achieving sufficient scale economies to make Canadian production internationally competitive.

may be obtained most easily by reference to Canadian trade with the United States alone. This approach will do little injustice to the true situation for the total deficit and the deficit on secondary manufactures with the United States are each only about $US 15 millions less than the relevant Canadian deficits with all developed PFTA countries. The question becomes, then, how much would the prices of Canadian secondary manufactures exported to the United States and competing domestically with imports from there have to diminish to remove the estimated deficit on merchandise trade with that country resulting from the static effects of free trade? Since there is an estimated $US 32 millions surplus on Canadian trade with the United States in the four non-secondary commodity groups, it would be sufficient if the price decline resulted in all but $US 32 millions of the deficit on secondary manufactures being eliminated.

A very simple and conservative approach is taken in answering this question. More sophisticated approaches can be developed, but it is doubtful that they would significantly alter the conclusion reached--that the required price decline is not more than what is economically feasible, given our present knowledge of the extent of present price differences between the United States and Canada.

Let:

M_{us} = 1965 United States imports of Canadian secondary manufactures adjusted for the Kennedy Round.

M_c = 1965 Canadian imports from United States of products competing with Canadian secondary manufactures, adjusted for the Kennedy Round.

t_c and t_{us} = weighted average,[1] post-Kennedy ad valorem duties on imports of secondary manufactures by Canada and the United States respectively.

E_c and E_{us} = relative price elasticities of demand for secondary manufactured imports by Canada and the United States respectively.

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[1]The weights are the value of imports in each of the three-or four-digit categories used when arriving at the original static estimate of the deficit resulting from a PFTA.

x = percent price decline in Canadian exports and import-competing products.

And assume:

(1) that U.S. producers do not alter their prices

(2) that the Canadian price reduction occurs at the same time as the tariff removal.[1]

(3) that with respect to exports the effects of the price decline and the tariff elimination both apply to the initial value of exports adjusted downward for the price decrease, and that these two effects are additive.

Then, the next expansion in the value of Canadian exports to the United States may be formulated as:

$$-M_{us} + \left[\frac{t_{us}}{1+t_{us}} + x\right]\left[M_{us}\,(1-x)E_{us}\right]$$

where $-M_{us}$ = the decrease in value of initial exports owing to the Canadian price reduction, and the remainder of the expression is the gross increase in the value of exports resulting from the removal of American tariffs and the lowering of Canadian export prices.

The enlargement in the value of imports will now be less than when no price decreases in Canadian import-competing goods occur and it may be expressed as

$$\left[\frac{t_c}{1+t_c} - x\right] M_c \cdot E_c$$

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[1]Implicit in this assumption is the further one that actually, there will be some transition period in which tariffs are removed and industry rationalizes. Many industries may be able to rationalize quite quickly because they will not need to build new plants but only reduce the number of lines produced in their existing plants.

Thus the equation for the change in merchandise trade when Canadian price declines are allowed for becomes:

$$-M_{us} + \left[\frac{t_{us}}{1+t_{us}} + x\right]\left[M_{us}\,(1-x)E_{us}\right] - \left[\frac{t_c}{1+t_c} - x\right] M_c \cdot E_c$$

$$= \ -32 \text{ millions}$$

which, when the known or estimated values of all variables except x, are substituted into it reduces to:

$$3510\,x^2 - 9387\,x + 428 = 0$$

The relevant solution is $x = .046$[1]; that is, a lowering by 4.6 percent[2] of the prices of Canadian secondary manufactures exported to the United States and competing with imports from the United States would be sufficient to eradicate the enlargement of the Canadian deficit on merchandise trade with that country that complete tariff elimination by both nations is otherwise likely to entail.[3]

This result assumes that production costs in other than secondary manufacturing remain constant. If one were to allow for lowered costs in these other sectors as well, as a result of lowered tariffs on imported materials and equipment and reduced prices of inputs supplied by Canadian secondary

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[1]The second solution is $x = 2.628$

[2]Several alternate formulations of the model have yielded results varying between 4 and 6 percent.

[3]Note also that if we assume that no decline in Canadian prices occures, then to avoid an increase in the deficit in Canadian merchandise trade with the United States, the relation between Canadian and American elasticities would have to be as follows: $E_{us} = .545 + 5.806\,E_c$

manufacturing,[1] then the surplus of merchandise trade in these sectors resulting from PFTA would be even greater than that computed above. Consequently, the price decline in secondary manufacturing necessary to eliminate the deficit on merchandise account would be less than 4.6 percent.

Other considerations would also affect the size of the required price reduction, although their net influence on this price decrease is not as clear cut. To illustrate, a PFTA would have to involve the elimination of all imports quotas (de facto or actual) and all domestic production or export subsidies by the participating countries. On the one hand, the elimination of de facto import quotas would place some Canadian secondary manufacturing industries in a much more unfavourable position than any simple tariff reduction would do. Examples are those industries producing clothing, textiles, some electronic equipment and plywoods and veneers. On the other hand other Canadian industries might in turn benefit from the removal of domestic or export subsidies by Canada's trading partners in a PFTA. I do not have sufficient information available to properly assess the relative strengths of these two opposing possibilities, but my guess would be that on balance, Canada might stand to gain. If this were so, then for this reason too, the price reduction necessary would be less than estimated above.

The discussion of several other factors which might alter the above conclusion is more appropriately left until the following section of this paper. What will now be considered is how this reckoning of the needed drop in Canadian prices compares with evidence on current divergence in prices between Canada and the U.S.

The most recent information available on comparative Canadian-United States prices is that by the Economic Coun-

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[1] As this phrase suggests, and as will be mentioned again shortly, economies of scale are not the only reason why Canadian costs of production may be lessened.

cil of Canada.[1] The relevant numbers are presented in Table 5. The groups shown are roughly comparable with what have been defined as secondary manufactures. Of course, many secondary manufactures are intermediate goods whose prices are not reflected directly in the above computations. They are indirectly, however, so that this does not seem to be a major limitation of the data.

A more important matter is that the Council's comparisons were made without adjustment for the exchange rate between the Canadian and United States currencies. Since the United States dollar is worth $1.081 Canadian, Canadian prices internationally would actually be lower relative to their U.S. counterparts than is indicated in the table. When the adjustment is made, the average of Canadian to U.S. prices for the three commodity groups becomes 105.2, and for the last two groups--durable consumer goods and machinery and equipment--it becomes 113.5.

On average, then, Canadian prices of secondary manufactures appear to be between 5 and 14 percent above the comparable U.S. numbers, depending upon what one chooses to include in this category. Although these computations are very crude and highly aggregative, they suggest that the 4.6 percent price decrease that would be necessary in Canadian secondary manufacturing would certainly not have to be more than the amount by which average Canadian prices presently exceed those of the United States. (Of course, since much intra-industry specialization would likely occur, the price decreases in some product groups would have to be much more than suggested here while production of other commodities would cease entirely).

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[1]See D. J. Daly and D. Walters, Factors in Canada-United States Real Income Differences, a paper presented at the Maynooth Conference of the International Association for Research in Income and Wealth, Ireland, August, 1967 (mimeographed), espec. pp. 6-7; also see an unpublished study by the Dominion Bureau of Statistics entitled, Comparative Consumer Price Levels in the United States and Canada, on which some of the Economic Council's computations were based.

TABLE 5

CANADA/UNITED STATES PRICES

FOR SELECTED COMMODITY GROUPS, 1965

(U.S. = 100)

Commodity Group	$\frac{\text{Can. prices}}{\text{U.S. prices}}$
Nondurables other than food	104.5
Durable consumer goods	119.5
Machinery and equipment	125.6
Average of all three items[1]	113.7
Average of durables and machinery and equipment	122.7

Source: See text.

Notes: [1]Weighted by value of expenditures on each commodity group in 1965 National Accounts.

Up to this juncture reference has been made primarily to the production cost decreases to be achieved by attaining economies of scale. But not all the cost reduction would have to come from this source. The removal of tariffs on imports of materials and capital equipment will also lower the costs of Canadian producers to some extent. For example, in the thirteen sectors examined by the Wonnacotts,[1] a simple, unweighted average of the saving to Canadian manufacturers that could be achieved from elimination of Canadian duties on imports of material inputs and capital equipment amounts to 3.2 percent of present Canadian costs.[2] The actual average saving would probably be less than this, because the drawback provisions in the Canadian tariff already provide for tariff remission on material inputs used in exports. However, such drawbacks do not apply to capital equipment imports; nor are they relevant when thinking in terms of the lowered costs of domestic production competing with imports. Hence, there is still likely to be some direct cost saving to Canadian manufactures from the elimination of import tariffs, even if it would not be as large as the above number suggests. Accordingly the reduction in costs that must originate from a rationalization of Canadian industry would be somewhat less than the 4.6 percent price decrease necessary to preclude the expansion of the deficit on merchandise trade with United States.

(3) Other Dynamic Influences. One must now, however, concentrate solely on the possible reduction in costs owing to economies of scale and lowered tariffs on materials and capital equipment, to the exclusion a number of dynamic considerations relevant to this discussion. The future development of world markets for Canadian exports of crude materials, new technology, scale economies in marketing, foreign (particularly American) ownership of Canadian manufacturing, and the degree of aggressiveness or resourcefulness shown by Canadian industry are all of some significance in trade liberalization. These matters are analyzed at much

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[1]They considered fourteen sectors, but one of them, automobiles, is excluded here, because the Canada-United States automobile pact has essentially eliminated all tariffs on shipments between the two countries--with the exception of tariffs on replacement parts.

[2]R. J. and Paul Wonnacott, Table 30, p. 224.

greater length in other papers.[1] In the space available here only some of the more important issues that are raised by the introduction of them can be indicated. Consider them in order.

Export markets for several Canadian raw materials may undergo substantial changes in the coming years. The opening of the Chicago market to Canadian petroleum could mean hundreds of millions of dollars of additional exports to this area. Also, growing world demand for uranium should improve Canadian export receipts significantly. The export of coal to Japan is another new possibility. Concurrently, however, increased international competition from new sources of raw material supplies such as Australia may cut into Canadian export markets. It is perhaps still too early to say what the next effect of these developments will be on the Canadian balance of payments. Nevertheless in discussions of the present type they cannot be disregarded.

Technological advance as a result of research and development is receiving more and more attention as a determinant of international trade in highly sophisticated products. Although the Canadian industrial research effort is minuscule compared with that of the United States and a number of other developed nations, recent evidence indicates that Canadian secondary manufacturing exports as a proportion of domestic production tend to be significantly larger in those industries where research and development is relatively more important. This finding is of considerable importance because in past economic discussions of the determinants of Canadian trade, new technology has been virtually ignored.

The significance of selling costs and economies of scale in marketing have also been downgraded too much in discussions of Canadian trade and the implications for Canadian industry

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[1]For a detailed discussion of the future development of world markets for Canadian exports of crude materials see the series of studies for the Private Planning Association of Canada, particularly those by D. Slater and D. Querin. For a review of the other issues see B. W. Wilkinson, op. cit., especially chapters V-VIII.

of free trade. There is now evidence that in those industries where there are substantial economies of scale in marketing, to be realized--that is, in the consumer goods industries--Canadian exports as a proportion of domestic output have tended to be less. The strongest export performance has occurred in the investment goods industries where the number of purchasers that must be reached in any country is relatively small and sales are often made directly to the manufacturer thus avoiding the commissions of middlemen, the need for large selling organizations and expensive advertising.

Foreign ownership of Canadian industry has had a number of effects. First, it has facilitated rapid transmission of new technology from foreign parents to Canadian subsidiaries. Second, it probably also has been a deterrent to rationalization of Canadian production. A Canadian-owned firm would be reluctant to commence any rationalization if it were to mean that some form of competitive warfare were to be initiated between it and a subsidiary with the immense resources of a foreign parent behind it. Where two or more subsidiaries are operating in an industry in Canada there would again be apprehension on the part of each one of them about starting any rationalization maneouvers which would have repercussions on their foreign parents. Third, imports tend to be larger the more of an industry that is under foreign ownership. This follows because the foreign subsidiaries, owing to their close association with their foreign parents (and in turn with the suppliers of these parents) will tend to possess or be able to obtain at lower costs of search, more information about foreign products and prices than would their domestically-owned competitors.

Foreign ownership also has important implications for the future of Canadian secondary manufacturing in the event of free trade. Because the bulk of foreign ownership is American, the argument may be framed primarily in terms of Canadian-United States trade although, as will be seen, the economic implications for Canadian participation in PFTA are fairly evident. On the one hand, with the Canadian tariff eliminated, there would be less incentive for U.S. firms to set up production in Canada as quickly as they have done in the past. The Canadian market could be supplied from their U.S. plants.

On the other hand, with the U.S. tariff gone as well, and with Canadian wage rates lower by 25 or 30 percent, there would be a greater incentive for them to locate in Canada. To the extent that new technology is an influential determinant of trade and some variant of the technological gap or product cycle theory of the trade is correct, the shift to Canada would occur as soon as production had passed into the stage where assembly line methods involving large amounts of unskilled or semi-skilled labour were possible.

But the question which arises is whether the cost advantage in Canada owing to lower Canadian wages would be sufficient to induce U.S. firms to transfer new production to Canada or keep existing production in Canada. Certainly it would not if the object were to produce in Canada to supply the Japanese market under a PFTA, because wage rates there are much lower again than in Canada. It would be less costly to locate there rather than in Canada.

If the object were to manufacture in Canada for the U.S. market the answer is less clear. A number of factors must be considered. First, it would only be important in the long run. In the short run, it may be cheaper for them to use their existing facilities in the United States--at least until the variable costs of operating them exceeded the total costs of operating a new, more efficient plant in Canada. But what would happen to wage rates in Canada in the long run is not certain. Historical experience regarding regional differences in wage rates both wihin Canada and the United States would suggest that such differences are very slow to be eliminated, so that one is prompted to argue that the wage differences are likely to be sustained long enough for it to be worthwhile to make the investment in Canada. But those making the investment decisions may not wish to rely on historical experience, especially when there is the thread that international unions may strike for wage parity across the border--possible because the U.S. unions fear that increased U.S. investment in Canada would reduce the rate of growth of opportunities for new jobs in the United States. Wage parity would eliminate the cost advantage of locating in Canada.

Second, if the decision meant that there might be a loss of the goodwill of the consuming public, of the unions, or of the government of the United States, or a loss of any privilege or preferences which are a function of this goodwill, there could easily be additional hesitation about locating new facilities in Canada. Third, there is always the possibility of a free trade arrangement breaking down--the thought of which would also add to the apprehension. This possibility might also spur Canadian producers to shift production to an American site because of the much larger U.S. market.

In short, there is a trade-off between the possible advantage of lower costs in Canada and the other advantages, real or imagined, of remaining in the United States.[1]

A common, although not pervasive, finding of empirical investigations of how American firms would behave in the event of free trade is that their facilities in Canada would tend to be phased-out and the Canadian market served from the United States.[2]

This does not mean, however, that there will be a wholesale (but gradual) withdrawal of all U.S. controlled production from Canada and that the entire Canadian market will be supplied from U.S. plants. Nor does it mean that Canadian secondary manufacturing would entirely disappear.

The present performance of foreign-owned firms in Canada probably speaks louder about their intended response to free trade than does economic theory or philosophical rea-

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[1]The suggestion that other factors beside cost reduction or profit maximization (as described in most textbooks of microeconomic theory) may motivate business decisions is far from new. For an excellent review of the literature see Y. Aharoni, The Foreign Investment Decision Process (Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1966) especially pp. 261-272. Unfortunately, most of this literature has been neglected by a large number of economists.

[2]See M. Kreinin, "Freedom of Trade and Capital Movements-Some Empirical Evidence," Economic Journal, 75 (December, 1965),pp. 748-58; also J. Polk, I.W. Meister, and L. A. Veit, U.S. Production Abroad and the Balance of Payments (New York: National Industrial Conference Board, 1966) espec. p. 120; and more recently, B.A. Keys, Medium-term Business Investment Outlook-1967 Survey a study prepared for the Economic Council of Canada (Ottawa: Queen's Printer, 1967), p. 12.

soning as to their political or patriotic motivations. Those that are already deeply engrossed in research and development and/or are competing internationally are likely to continue to do so--on a bigger scale. They have already taken their stand about their operations in Canada. Moreover, since "follow the leader" is an important part of the foreign investment decision process, the example of some U.S.-owned firms in an industry thriving in Canada may lead competitors to join them.

As for Canadian-owned manufacturing, however, substantial aggressiveness and resourcefulness will have to be exhibited if the challenge and the opportunities of trade liberalization are to be successfully met. For a Canadian producer to obtain a share of the world market or of the PFTA market, it will require a product that buyers want (or can be persuaded they want) and attention to buyers' wishes. This in turn implies original research and development or competent and rapid imitation. It also implies the need for vision and foresight to see the potential of new markets; the willingness to take risks; well-qualified salesmen; for some products, large-scale selling organizations; and for many buyers, liberal credit. Moreover, it requires the use of modern technology (e.g. computers) in inventory and other cost, control, production scheduling, inspection and so on.

Those domestic-owned companies that have already exhibited the initiative, imagination, and foresight to undertake research and development in Canada, that have searched out opportunities for sales abroad, have established foreign sales contacts and/or foreign marketing organizations, and have thereby forged their way into the world's markets will perhaps be able to cope most successfully with the challenge of free trade. But there is no reason why other firms too, if they respond appropriately cannot survive and thrive. Government assistance will be an important part of the adjustment process, but a discussion of this topic is far beyond the scope of this paper.

In conclusion, a Pacific Free Trade Area would create many difficulties for Canadian secondary manufacturing, but it would also provide immense opportunities. Much intra-industry specialization would undoubtedly take place as firms specialize more fully, lengthen their production runs and where necessary, construct larger plants. But the achievement of economies of scale is not enough. Constant improvement of products and processes and aggressive selling abroad will also be essential if Canadian manufacturing is to develop its full potential under trade liberalization.

APPENDIX

Commodity Classification Used in This Paper

(Based on SITC)

(1) Crude Foodstuffs and Feed: 001, 025, 041-045, 051, 054, 061, 071-075, 121.

(2) Crude Materials: 211, 212, 221, 231.1-231.4, 241, 242.2-242.4, 242.9, 243.1, 244, 261-267, 271-276, 281-286, 291, 292, 321, 331, 341, 351, 411, 421, 422, 431.

(3) Processed Foodstuffs: 011, 012, 013, 022, 023, 024, 031, 032, 046, 047, 048, 052, 053, 055, 062, 081, 091, 099, 111, 112, 122.

(4) Primary Manufactures: 242.1, 243.2, 243.3, 251, 332, 611, 613, 631, 632, 641.1, 661, 662, 663, 666, 671, 672, 681-689.

APPENDIX TABLE 1(a)

CANADIAN EXPORTS TO PFTA COUNTRIES, 1965
(MILLIONS OF U.S. DOLLARS)

	U.S.A.	Japan	Australia	New Zealand	PFTA	Percentage Each Group of the Total
Crude Foodstuffs	112.2	97.5	.6	-	210.3	4.1
Processed Foodstuffs	336.3	5.6	3.1	1.2	346.2	6.8
Crude Materials	943.7	115.3	13.2	1.8	1074.0	21.1
Primary Mfg.	1990.8	54.8	38.1	9.5	2093.2	41.1
Secondary Mfg.	1258.6	18.7	75.9	20.3	1372.5	26.9
TOTAL	4641.6	291.9	130.9	32.8	5097.2	100.0

APPENDIX TABLE 1(b)

CANADIAN EXPORTS TO PFTA COUNTRIES, 1965
(PERCENTAGES)

	U.S.A.	Japan	Australia	New Zealand	PFTA
Crude Foodstuffs	53.3	46.4	.3	-	100.0
Processed Foodstuffs	97.1	1.6	.9	.3	100.0
Crude Materials	87.9	10.7	1.2	.2	100.0
Primary Mfg.	95.1	2.6	1.8	.5	100.0
Secondary Mfg.	91.6	1.4	5.5	1.5	100.0
TOTAL	91.1	5.7	2.6	.6	100.0

APPENDIX TABLE 2(a)

CANADIAN IMPORTS FROM PFTA COUNTRIES, 1965

(MILLIONS OF U.S. DOLLARS)

	U.S.A.	Japan	Australia	New Zealand	PFTA	Percentage Each Group of Total
Crude Foodstuffs	207.2	2.2	8.3	.3	218.0	3.9
Processed Fooodstuffs	137.1	5.9	21.3	4.1	168.4	3.0
Crude Materials	502.8	.4	8.5	9.1	520.8	9.3
Primary Mfg.	268.8	15.7	.7	-	285.2	5.1
Secondary Mfg.	4246.5	185.9	3.4	-	4435.8	78.8
TOTAL	5362.4	210.0	42.2	13.5	5628.2	100.0

APPENDIX TABLE 2(b)

CANADIAN IMPORTS FROM PFTA COUNTRIES, 1965

(PERCENTAGES)

	U.S.A.	Japan	Australia	New Zealand	PFTA	Each Commodity Group Of Total
Crude Foodstuffs	95.0	1.0	3.8	0.1	100.0	3.9
Processed Foodstuffs	81.4	3.5	12.6	2.4	100.0	3.0
Crude Materials	96.5	.1	1.6	1.7	100.0	10.1
Primary Mfg.	94.2	5.5	.2	-	100.0	4.2
Secondary Mfg.	95.7	4.2	0.1	-	100.0	78.8
TOTAL	95.3	3.7	.7	.2	100.0	100.0

APPENDIX
TABLE 3
MANUFACTURED IMPORTS AND EXPORTS BY MAJOR INDUSTRY GROUPS, AS PERCENT OF TOTAL MANUFACTURED IMPORTS AND EXPORTS AND AS PERCENT OF DOMESTIC PRODUCTION, AND DUTIES COLLECTED AS A PERCENT OF TOTAL IMPORTS, 1963

Major Manufacturing Industry Groups	Imports as Percent of Total Manufactured Imports (1)	Exports as Percent of Total Manufactured Exports (2)	Imports as Percent of Domestic Production (3)	Exports as of Domestic Production (4)	Duties Collected as Percent of Total Imports (5)
Food and Beverages	7.3	11.7	6.4	9.3	14.9
Tobacco Prouducts	0.1	0.6	2.1	8.3	38.1
Rubber	0.9	0.3	11.5	4.1	20.1
Leather	0.7	0.3	11.5	4.6	17.3
Textiles	5.8	0.8	26.1	3.0	21.3
Knitting Mills	0.5	0.1	10.4	2.0	30.2
Clothing	0.9	0.3	4.8	1.3	26.0
Wood	1.4	12.1	5.6	43.1	7.3
Furniture and Fixtures	0.4	0.1	4.3	0.9	25.9
Paper and Allied	1.6	26.8	3.3	50.0	15.0
Printing, Publishing & Allied	2.4	0.2	12.3	1.0	4.9
Primary Metal	4.6	19.3	7.5	28.3	4.6
Metal Fabricating	7.6	2.7	20.2	6.4	15.1
Machinery (except electrical)	23.0	6.0	130.1	31.1	7.0
Transportation Equipment	15.8	5.8	27.7	9.3	9.2[2]
Electrical Products	7.7	3.1	25.0	9.3	17.1
Non-Metallic Minerals	2.5	0.5	16.1	2.9	10.3
Petroleum and Coal	2.0	0.2	7.4	0.6	6.7
Chemicals and Chemical Products	8.4	6.7	25.5	18.7	8.5
Miscellaneous Manufacturing	6.4	2.3	42.7	14.0	11.6
	100.0[(1)]	100.0[(1)]	17.3	15.7	11.3

Source: J. W. Wilkinson. Canada's International Trade: Analysis of Recent Trends and Patterns. (Montreal: Private Planning Association of Canada, 1968).

Notes: (1) Percentages may not add to 100.0 due to rounding.
(2) Would now be much lower owing to Canada-United Stages Automobile Pact.

SESSION I

COMMENT ON H. E. ENGLISH'S PAPER
by Richard N. Cooper

I am not an expert on Canadian commercial policy, and I found Professor English's discussion of its plitico-historical origins most illuminating. I will confine my remarks to two broad points.

First, economists have long been baffled as to why the productivity of the Canadian economy is so much lower--by about one-third--than that of the United States. This despite the fact of the same general background of the peoples and the greater resource endowment, per capita, in Canada. Large discrepancies exist even when regional differences within each country are taken into account. The gap is so large that it cannot be attributed to errors in measurement.

Trade experts like to attribute this "productivity gap" to protectionist commercial policies--both in Canada and in Canada's trading partners, notably the United States. Canada's tariffs pull Canada's resources into uneconomic manufacturing production, and tariffs of Canada's trading partners allegedly prevent Canada from exploiting the economies of large scale production in some manufacturing lines.

I am skeptical that Canadian free trade and tariff-free access to the U.S. market would eliminate this productivity gap. It is worth recalling that, insofar such figures can be relied on, the productivity gap existed well over a century ago, before the advent of Canada's policy to stimulate manufacturing production through tariff protection. Nonetheless, the gap seems to have widened since the 1870's, and I am sure that trade barriers contribute some-though I would guess the smaller part--of this gap. Canada's market is by no means a small one; Canada is the seventh or eighth largest national economy in the non-communist world. And it has had preferred access to the British market for many years. Nonetheless, I would agree with English's point that tariffs have resulted in excessive product differentiation, and this fact has prevented exploiting economies of scale that the size of the market would otherwise permit.

Moreover, in assessing the effect of tariffs--or the removal of them--on Canada's standard of living, it is necessary also to take into account the impact on capital movements into Canada. This is a complex area, but it would be reasonable to conjecture that Canada's tariff has induced foreign direct investment in Canadian manufacturing, and this may have increased Canada's total capital stock. Tariff removal would, I believe, greatly reduce the net inflow of direct investment capital into Canada below what it would otherwise be. (This has implications for the balance-of-payments consequences of free trade for Canada as well.)

My second point concerns the broad area of trade policy choices that we face. Professor English rejects, for good reasons, the sectoral approach to free trade. Given the complex and strong interrelations among different "sectors"--defining a sector is itself difficult-- sectoral free trade would involve high risks of distorting the allocation of resources.

But he endorses a regional free trade area among like-minded countries, open-minded and outward-looking, apparently in preference to further generalized tariff reductions of a type brought about by the Kennedy Round of tariff negotiations. It is not entirely clear whether this preference results from the judgement that another Kennedy Round, although preferable on its merits, is not likely to take place, or from the belief that a regional free trade area is likely to offer a more significant step toward free trade than would another negotiation of the Kennedy Round type.

In my view, the strength of our interest in a regional free trade area must depend heavily and inversely on our assessment of the prospects for a successful second Kennedy Round, which would be preferable on its merits. (I have indicated briefly why I regard it as preferable in my own paper.) I believe, furthermore, that the prospects are not so bleak as Professor English seems to feel. It is true that the negotiators at the Kennedy Round are now weary, and would not relish the prospect of going through another round of tariff negotiations in the near future. The Kennedy Round tariff reductions will be phased over a five-year period, and will not take full effect until 1972. I would guess that by that time the groundwork for further generalized reduction in tariffs (and in some non-tariff barriers) could have been laid. The time necessary to work out the details of a free trade area and generate the required public support would surely be as long.

This does not mean, however, that discussion of a Pacific Free Trade Area is not fruitful. On the contrary, such discussion will usefully draw attention to the important trading relationships among the countries around the Pacific. In addition, in the event a second Kennedy Round should not materialize, a Pacific Free Trade Area, particularly one open to general membership such as Professor English proposes, would become an attractive alternative; and it is useful to start now laying the necessary groundwork and doing the necessary analysis.

COMMENT ON B. W. WILKINSON'S PAPER
By Shigeru Fujii

Professor Wilkinson's paper is compos of three main parts:

1) Main features of current Canadian Trade patterns and trends;

2) Estimation of static effects of Kennedy Round; and

3) Estimation of static and dynamic effects of PAFTA.

1) First of all, I am deeply interested in the commodity composition of Canadian trade shown in Table 2 (p.35), which indicates a conspicuous contrast to that of Japan.

Endowed with rich natural resources, actual as well as potential, Canada is able to increase the share of crude materials in exports and decrease their share in imports, along with increasing shares of end products both in exports and imports--that is, in the process of furthering industrialization.

In this respect, it would have been of more help to us in attaining a clearer understanding about the features of Canadian trade, if Professor Wilkinson had presented the percentage shares of respective goods or materials in production or output, too. We would have been able to compare, for example, the shares of commodities in exports and production.

2) As to the estimation of the static effects of Kennedy Round and PAFTA, I have learned much from the paper, for which I should like to say "Thank you very much."

3) As to the dynamic effects of PAFTA, Professor Wilkinson seems to put emphasis on economies of scale. Here Professor Wilkinson expects or hopes for beneficial effects of trade liberalization on secondary manufacturing industry in lowering production costs and hence lowering prices so as to be more internationally competitive; for the removal of tariffs of other PAFTA countries would extend the opportunities for exporting and hence for achieving economies of scale in production for Canadian producers, and the removal of Canadian protection would offer the necessary stimulus to Canadian producers to modernize and rationalize their production.

Professor Wilkinson goes further to estimate the degree of price decline in secondary manufacturing necessary to eradicate the deficit on merchandise account that might otherwise occur from the tariff elimination. For this purpose, he gives an elegant formula with three asumptions, and finds that a lowering by 4.6 percent of the prices of Canadian secondary manufactures exported to the United States and competing with imports from the United States would be sufficient to eradicate the supposed trade deficit with the United States.

So far, I can follow Professor Wilkinson's reasoning fairly well, and agree with him in principle. There remains, however, one question which I should like made clear. The point is concerned with the second assumption on p. 56. Professor Wilkinson assumes that the Canadian price reduction occurs at the same time as the tariff removal. However, price reduction by way of economies of scale or rationalization usually takes time. I am afraid that many things, expected and unexpected, might occur in the time interval between the tariff removal and the actual price decline. The final effects are difficult to ascertain, especially when the behavior of the U.S.-owned firms in Canada is taken into account as one of the dynamic influences of PAFTA.

Thus, unlike the two other assumptions, this second assumptions, I am afraid, would reduce the feasibility of estimating the dynamic effects in spite of Prof. Wilkinson's elegant formula.

DISCUSSION ON ENGLISH'S AND WILKINSON'S PAPERS

In reply to comments on his paper, Prof. English first made the general point that a restructuring of the Canadian economy would involve not only production rearrangement but also adjustments in marketing, research, and development activities. With regard to Prof. Cooper's second point, Prof. English stressed that recent trends suggest that Canada might be ill-advised to accept the cost of waiting for further global, Kennedy-Round type negotiations to take place. In this connection, he did not see why a regional approach need be an alternative to a multilateral approach; the former could be a means to a multilateral end. In short, Canada might come to favour the idea of PAFTA.

Concerning the assumption of immediate price reduction after the removal of tariffs, Prof. Wilkinson explained that tariff removal would actually be staged over a period of time and that the scale effects would derive mainly from the length of run rather than mere horizontal size. This means that the transition would not take so much time as it would, if it started from scratch. With respect to the discussant's first point, the author referred to Appendix Table 3 of his paper where the data on total manufacturing output are provided in relation to trade statistics.

The discussion from the floor centered on the possible impact of trade liberalization on (1) industrialists' attitudes, (2) the possible dynamic effects of trade liberalization in the secondary sector, (3) the position of agriculture, and (4) the balance-of-payments issue.

(1) It was argued that the leading managers in Canadian manufacturing industry would be favourably disposed toward a move to freer trade, despite a traditionally highly protectionist atmosphere, which might still linger among the smaller firms with less managerial confidence.

(2) Unfortunately it appeared difficult to make any satisfactory generalizations on the basis of the recent Canada-United States automobile agreement, for it is a highly controlled arrangement. Moreover, American firms have tended to cover themselves very well. For example, they were supposed to increase the Canadian content of production. This they achieved by reinforcing the assembly line system rather than increasing the purchase of Canadian parts.

It is difficult to predict whether or not Canadian manufacturing production would increase where the majority of her industries are dominated by American-owned firms.

(3) The impact on agriculture appeared to be less significant for Canada than either for Australia or New Zealand. This is partly because she has had little difficulty in finding the export markets for wheat (i.e. China, U.S.S.R., and developing nations), although she would, of course, welcome the opportunity to widen her markets in agricultural products, such as dairy products, in the United States. Canadian farmers have generally favoured free trade because it would keep down the high cost of imported goods. In any case, agriculture can be treated separately from manufactures, provided sufficient impetus for rationalization is given to the latter.

(4) Trade liberalization could call for three kinds of adjustments which have an important bearing on the balance of payments:

(i) a general reduction in price levels;

(ii) the narrowing of wage differentials between the United States and Canada; and

(iii) exchange rate adjustment.

The Canadian view was that (ii) would be most vital among the three. Put another way, Canada could avoid serious adjustment problems so long as wage differentials did not disappear too rapidly. It was felt that institutional factors were important in judging whether there would be too rapid a disappearance of North American wage differentials.

The above view invited the comment that Canadian economists generally assume that monetary adjustments will take place and put emphasis on the possibilities of lowering price levels. But (i) and (ii) are associated more with welfare implications and the discussion of monetary adjustments should be made explicitly. It was observed that the Canadian balance of payments might face difficulties depending on the direction of capital inflows and on the policies of American-owned firms in Canada, such as whether or not to purchase intermediate products from the United States.

Chapter 3 NEW ZEALAND TRADE AND AID POLICIES IN RELATION TO THE PACIFIC AND ASIAN REGION

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I Introduction

A dozen years ago the task of writing a paper on this subject would have been simple; for, in the mid-fifties New Zealand official thinking on foreign economic policy was firmly centred around the country's historic relationship with the United Kingdom. There was in addition some concern for multilateral trading relationships as expressed through the GATT. But this was essentially subsidiary derived more from the priociple that small countries had an interest in supporting collective security in economic as well as in defence matters than from the facts of New Zealand's own pattern of trade relationships. There was certainly very little interest in trade with Asia, these countries generally being regarded as offering no prospect in decades of becoming markets for the type of foodstuffs exported by New Zealand. In the case of Japan, memories of the War and the fear of what might eventually be entailed for Zew Zealand industry were still much too strong in 1955 to permit any serious attention being given to future trade contacts with that country.

In the fields of defence and international politics, however, developments in Europe as well as in Asia were already forcing New Zealand to shift the focus of its interest and commitment to the Asian and Pacific region. Indeed although there is significant dissent about the nature of official policy, there is now fairly broad acceptance in New Zealand that its primary political and security interests lie in the Pacific and Asian region and not, as in the past, in Europe and the Middle East.

These changes in the orientation of political interests have not been matched by a similar degree of change in the field of foreign trade policy. Certainly one can detect after 1956 a much stronger interest in developing trade and economic relations with the United States, Canada, Australia, Japan, the Philippines, Malaysia and other countries of the Asian and Pacific region. Government sponsored trade missions to these countries on several occasions; trade treaties (within the GATT framework) have been concluded and exporters actively encouraged by Government to develop these markets in particular. Nevertheless, much of this new-found interest in Asia and the Pacific is merely an aspect of the more general attempt by New Zealand to reduce the degree of dependence on the United Kingdom market and to divert as much as possible of New Zealand's increasing exports of primary produce elsewhere - a response to the expectation ("apprehension" would be a more appropriate term) that the United Kingdom could not, for one reason or another, indefinitely absorb at satisfactory prices for New Zealand a 3% per annum increase in imports of meat and dairy produce. Thus with an eye on increasing exports generally much of the emphasis in New Zealand's trade policy in recent years has been directed at opposing agricultural protectionism in Europe and North America and relatively less attention has been given to the development of markets in Asian and Pacific countries and to the policy measures that such a re-direction of emphasis might require. Nevertheless, the change in the pattern of New Zealand's trade over the past decade have been quite significant as the following Table indicates:

TABLE I

Direction of New Zealand Trade

% of total

Country	Exports 1938	1956	1966	Imports 1938	1956	1966
United Kingdom	84.2	64.6	42.2	47.9	53.7	37.2
Australia	3.8	3.1	4.6	12.9	14.2	19.3
Canada	1.9	1.5	1.4	8.8	2.7	4.1
United States	2.5	7.1	15.8	12.4	7.6	11.2
Japan	1.0	1.0	8.4	2.2	1.0	5.7
E.E.C.	4.2	16.0	14.2	4.2	6.1	6.7
Other	2.4	6.7	12.8	11.6	14.7	15.8
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source: New Zealand Official Year Book

A striking feature is of course the extent to which New Zealand's dependence on the United Kingdom market has fallen since 1938. Part of the explanation is that with the relative decline of the United Kingdom wool textile industry, the United Kingdom now takes a much lower share of New Zealand wool exports; but another important factor is that the United States has displaced the United Kingdom as the major outlet for New Zealand beef. The European Economic Community countries are now of considerably greater importance as a market for New Zealand exports than they were in 1938 but this is mainly because of their much larger proportion of New Zealand wool purchases. Other products are of rather less significance, indeed the declining E.E.C. share of recent years can be attributed to the decreased importance of wool in total New Zealand exports. The Table also highlights the greatly increased importance to New Zealand of Japan and the United States as trade partners. Sales of beef, wool and dairy products (other than butter) to the United States have expanded very substantially in the past decade and there is a growing number of minor products including some manufactured goods in this trade. The increase in exports to Japan has been even more striking since much of this has occurred during the past five or six years. Wool has always been a major component but sales of mutton, milk powder, casein and forest products have expanded very rapidly. "Other" countries in the Table are a fairly diverse group but the most significant markets include Malaysia, Philippines, Thailand and India. Overall, about 33% of New Zealand exports are now directed to the four developed countries of the Pacific basin plus Southeast Asia compared with less than 10% in 1938 and 15% in 1956.

To a country whose trading relationships had remained more or less unchanged in the fifty years prior to the Second World War, these changes in the direction of trade since 1956 look very dramatic. For the most part, however, they have resulted from influences other than specific policies of the New Zealand Government to effect such market diversion. Economic growth in Japan, the United States and Europe and changing patterns of consumption in these countries and in Southeast Asia have been of more fundamental significance. Trade treaties with Japan, Philippines and Malaysia have undoubtedly been important in providing a general framework for building up Government and commercial contacts but the expansion of trade could never have proceeded as rapidly as it has done unless the underlying basis for profitable exchange had not existed. Far from there have been any general change in New Zealand's outlook in foreign trade policy from her connections with the United Kingdom to new relationships in the Pacific it is clear that the former remains of primary concern to New Zealand policy makers and to the major exporting interests represented by the New Zealand Daily Board and the New Zealand Meat Board. For it is true that, despite the decline in the extent of dependence on the United Kingdom market since 1938, there has been very little change with respect to three key products - butter, lamb and cheese. These products comprised 40% of total exports by value in 1965, with the United Kingdom market taking 92%, 89%, and 86% respectively. The protection of New Zealand's rights of unrestricted duty-free entry to the United Kingdom thus remains a central aim of New Zealand policy because no prospects are seen for the development of markets elsewhere for even a small part of what New Zealand now sells there. However, there are or appear to be, two other points which are relevant to this attitude. The first is that a major expansion of trade links with Japan or even with Australia, if attempted too rapidly, may well require New Zealand to introduce substantial changes in its present policies of protection for manufacturing industries. This is a nettle the New Zealand Government would prefer not to grasp, although it may be forced to do so in any case before very long. Secondly, there is an understandable reluctance to move away from trading relationships which in the past have expressed also the close cultural, emotional and kinship ties that have long existed between the United Kingdom and New Zealand. For many in New Zealand - and her policy-makers are not immune from such feelings - the comfortable, United Kingdom-dependent, quasi-colonial status of New Zealand in economic matters, is much to be preferred to the rigour of living and trading with partners who do not share these other non-economic ties. Why, it is asked, should New Zealand turn away from the United Kingdom to its Pacific neighbours when that course may turn out to have been unnecessary? This emotional element in New Zealand attitudes can be put on one side for the moment for it is unlikely to be of real significance in blocking policy changes if it should be clearly seen that a policy of dependence on the United Kingdom it is preventing the attainment of certain material goals which are valued more. The strong disposition not to abandon this long-standing feature of New Zealand trade policy is not by any means irrational; but a principal question which policy-makers are now facing is whether it remains relevant in terms of the essential policy objectives of economic growth and the maintenance of full employment.

II Trade Policy and Economic Development

The dominance of the United Kingdom as New Zealand's principal trading partner merely reflects the way in which economic development as an export-led process got under way in New Zealand in the latter part of the nineteenth century. Prior to the 1880's the main stimulus to development and settlement after the early colonisation efforts came from the discovery of gold and the development of wool production on extensive natural and artificial grazing lands. There is some evidence, however, that by the end of the 1870's the impetus given to economic growth by these forces had begun to peter out. The gold deposits having been largely exhausted and other mineral resources being scarce there was nothing much left to exploit and nothing very substantial on which to base a vigorous manufacturing economy. The introduction of refrigerated transport, however, opened a completely new chapter since it made possible the exploitation of New Zealand's main resource --a favourable climate - by specialisation in pastoral farming to produce meat and dairy produce for export. The years that followed saw a remarkable growth in such exports and the development of meat production resulted also in a significant expansion in output and exports of its joint product - wool - and other less important by-products of the meat and dairy industries. This development process was materially assisted by a high rate of immigration (which during the last quarter of the nineteenth century averaged around 6% per annum) and by a sustained programme of public investment in roads, railways and ports which contributed much to opening up the country for settlement. Furthermore, a large part of the manufacturing growth in this period was directly stimulated by expansion of agricultural output. Meat preserving and freezing, manufactured dairy products, fertiliser plants, vehicles and farm machinery industries were quickly established especially with the assistance of foreign capital.

The pointis, however, that all this would have been of little avail if England for her own good reasons unconnected with New Zealand as such had not followed an open door policy as regards agricultural imports. With the open door, the decline of English farming and the rise of English living standards, the more New Zealand produced the more the English were prepared to buy at, on the whole, very profitable prices. Furthermore, the more important these exports became the more energy, management skill and scientific research were devoted to raising the level of productivity and quality of the product. This cumulative process meant too that relatively speaking New Zealand became very specialised even within the agricultural sector (grain production rapidly declined from the 1890's) and became very dependent upon a market 12,000 miles away which in the late 19th and early 20th centuries had no rival in the vigour with which it pursued a free trade policy. The scale and nature of New Zealand's development in the period 1880-1930 was determined by that policy more perhaps than by any other factor. And of course it suited England just as it suited New Zealand. New Zealand might, in other circumstances have been able to develop a more diversified economy; perhaps also the population would be even smaller than it is now; and, with less dependence on a small range of primary produce exports New Zealand might have been better placed to meet the challenge of a world trading regime in which agricultural products are unwelcome. But New Zealanders would almost certainly have had a lower standard of living than they now enjoy.[1]

The Ottawa Agreement of 1932 formalised and to some degree extended what had in practice been the trading arrangements between the United Kingdom and New Zealand previously. New Zealand, under the ebullient, imperialistic R. J. Seddon had unilaterally established preferences for United Kingdom and other Empire goods in 1903 by increasing duties on "foreign" goods and these preferences were increased and extended in several tariff measures in later years. Under the Ottawa Agreement New Zealand undertook to preserve existing margins of preference where those margins did not exceed 20% and not to reduce any margin to below 20% except with the consent of the United Kingdom. New Zealand remained free to do what it liked about preferences in excess of 20% (the "non-contractual" preferences as they became known) but there was a limited obligation to consult the United Kingdom about proposed changes. In addition, some rates of duty on

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[1]Professor K. Kojima refers to this situation as one of "forced comparative advantage" See his article "An Impression of the Oceanian Economy": Economic Record March, 1964. I do not share this view.

British goods were bound; some were reduced; and New Zealand also undertook to protect only those industries which seemed likely to be economic eventually. This latter provision was weak and very general and the United Kingdom rarely exerted much pressure on New Zealand tariff-making freedom through it, largely because import licensing became after 1938 the principal instrument of protection.[1]

On the United Kingdom side, the Ottawa Agreement with New Zealand formalised certain duty preferences established for Commonwealth countries under the Import Duties Act of 1932. Apart from preferences of 15% on cheese and 15/- per Cwt on butter the most important aspect for New Zealand was that, while providing for the imposition of quotas on New Zealand produce in certain circumstances, in fact unrestricted duty free entry to the United Kingdom market was guaranteed for virtually all of New Zealand's exports.

The economic links with the United Kingdom were tightened still further on the outbreak of war in 1939. The United Kingdom became the sole purchaser under bulk purchase agreements of the whole of New Zealands export surplus of meat, dairy produce, wool and tallow. Prices were negotiated annually and agreement was also reached on the percentage of total output which New Zealand might send to other markets. The United Kingdom interest was of course to ensure a steady supply of relatively cheap produce and it was often not assy for New Zealand negotiators to secure United Kingdom agreement to an increase in this "other-market" percentage. This provision tended therefore to inhibit any vigorous efforts by New Zealand to diversify markets while the bulk purchase arrangements remained in force.

The original intention had been that the bulk purchase agreements would remain in force for the duration of the war. Bulk purchase of wool ceased after the sale of the 1945/46 clip, the auction system being reverted to. Early in 1944 however long term contracts (for a four year period) were entered into for meat and dairy products and these were extended in 1948 for a further period of seven years. These arrangements reflected, on the New Zealand side, a desire to achieve stability in

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[1]It became more relevant after 1950 when New Zealand began to dismantle the import licensing system and to substitute higher tariffs.

export prices and sales for these products and on the United Kingdom side the desire (since food was still being rationed in the United Kingdom in the post war years up to the early 50's) to have assured supplies at low prices. Government-to-government trading moreover was in keeping with the general political philosophy of the Labour Governments which were in power in both countries until the early 1950's.

The Conservative Government which came to power in the United Kingdom in 1951 quickly moved toward the abolition of foodstuffs rationing and in association with this moved also to terminate the bulk purchase arrangements with New Zealand. These were due to expire in 1955, but after discussion with New Zealand the contracts for meat and dairy produce were terminated in mid-1954. This simply meant that the trade now reverted to private enterprise channels. Unrestricted duty free entry to the United Kingdom market continued and in the case of meat was made firmer by an agreement concluded in 1952 under which the United Kingdom explicitly guaranteed to permit the entry of New Zealand meat without quantitative restriction until 1967. The same provisions were extended to dairy produce as part of the revision of the Ottawa Agreement in 1959. In both cases this undertaking was in 1966 extended to 1972 subject to certain qualifications essentially related to possible British membership of the E.E.C. and to the fact that a quota system for butter was being operated by the United Kingdom.[1]

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[1] This quota system also applies to New Zealand and was in fact introduced by the United Kingdom in 1961 with New Zealand's agreement, especially in order to prevent excessive dumping of butter in the United Kingdom market by European and other suppliers about which New Zealand had strongly protested in the G.A.T.T. and directly to the United Kingdom. New Zealand would have preferred the United Kingdom to use anti-dumping or countervailing duties, but the quota system is certainly better than a "free-for-all". Moreover New Zealand is well treated in the allocation of the quota and indeed for practical purposes they hardly amount to quantitative restrictions.

The tariff preferences granted to the United Kingdom in return must be counted as part of the cost of these advantages. Under the Agreement as revised in 1959, New Zealand guarant-

The greater scope achieved by New Zealand in the 1959 Agreement for the reduction of margins of preference was intended to give New Zealand more bargaining coin in G.A.T.T. especially in negotiations with the E.E.C. countries. But little use has been made of this, mainly because the increased trade with New Zealand that such reductions might permit have, reasonably enough, not been considered sufficiently worthwhile by other countries in exchange for a reduction of restrictions on New Zealand agricultural exports. A greater possibility for an exchange of concessions may however be much more relevant in the context of developing trade with Japan and with other Pacific countries. I return to this point later.

The provisions guaranteeing unrestricted duty free entry for New Zealand exports (even of manufactured goods) continue to be regarded in New Zealand as of the utmost importance. They have undoubtedly helped to give greater confidence to farmers, especially in the early 1950's, that any increased output from investment in pastures, livestock, processing facilities and fertiliser plants would be able to be sold. But on the other hand this may well have been a deceptive security and have inhibited any incentive to broaden out into other markets on any extensive and permanent scale. Moreover unrestricted entry for New Zealand has usually also meant unrestricted entry for all other exporters. There has never been any guarantee that the United Kingdom would, other than by tariffs, restrict the entry of competing supplies from other sources.

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ees for the most part minimum preferential margins of 5, 7.5 or 10 per cent and some of them were increased in the further revision of the Agreement in 1966. But actual margins are often well above the minimum. In the case of motor vehicles for example the preferential margin is 39% c.k.d. and 35% assembled. Unfortunately no detailed studies have been made in New Zealand of the effect of these preferences on import costs. Some limited work suggests that British goods tend to be priced so that most of the benefit of the margin over non-British goods is gained; a practice which has been made more possible by the effects of import licensing in restricting imports and in tying channels of trade.

Nor could the United Kingdom do so under the terms of the G.A.T.T. Furthermore the United Kingdom has not been prepared to accept any serious limitations on its freedom to encourage the expansion of its own agricultural output through its system of deficiency payments to farmers. In the case of lamb for example the deficiency payment has sometimes been as high as 50% of the market price.

Until about 1956 New Zealand confidently expected that these trading arrangements would continue to provide the principal basis for the maintenance of her export income over the long-term. But with rapidly rising United Kingdom output of meat and milk, the slow growth of United Kingdom consumption and the emergence of European and North American surpluses of dairy products on world markets New Zealand began to realize that she could not rely upon the United Kingdom market to absorb indefinitely a steady increase of about 3% per annum in New Zealands exports at increased prices.

New Zealands concern about policies of agricultural protection dates from about this time, even though such policies had commonly been practised in most countries for decades. But because of the special trading agreements with the United Kingdom there had never been any need to worry about what might be happening in the rest of the world or for that matter what might happen in the future. New Zealand farmers (who have always had a most powerful influence on New Zealand trade policy) were interested only in "facts" not in the prognostications of economic theorists. The "facts" were that New Zealand had guaranteed markets in the United Kingdom; prices were good; if they should go down, they would always rise again and were still better than could be got anywhere else. Moreover the products, especially lamb, were highly specialised for the English taste. To make any change would require a change in the structure of the meat and hence of the wool industry, change of breeds and change of production and processing practices. These arguments are still advanced by farmers but certainly have much less force now than they had in 1956-58. Perhaps the most important factor in diluting the optimistic complacency which prevailed in farming and government circles until this time was the attempt by the United Kingdom to reach some accommodation with the emerging European Economic Community. The first proposals for a Free Trade Area embracing OEEC countries but excluding agricultural products were not seriously opposed by New Zealand although reservations of principle about the growth of regionalism were made. The failure of the negotiations indeed worried some in New Zealand especially in official circles because it was realized that the next move by the United Kingdom would almost certainly be an application to join the Community without making a blanket reservation for agricultural products.

The move, when it did come, was greeted with a mixture of rage and incradulity on the part of many New Zealand farmers and their attitudes were a serious handicap over the next year or so in developing appropriate policy responses to the changed attitude of the United Kingdom. The general approach of New Zealand during this time was to secure if possible a firm undertaking from the United Kingdom that she would not join the EEC unless New Zealand interests were safeguarded. Some such words were indeed uttered by Mr. Duncan Sandys but the United Kingdom and the New Zealand interpretations differed widely. New Zealand farmers and many among the general public simply could not believe, in spite of the evidence, that the United Kingdom would ever contemplate imposing tariffs on New Zealand goods while allowing imports from EEC countries to enter duty free, or that quantitative restrictions would be imposed on New Zealand butter, cheese and meat to favour European suppliers as the common agricultural policy would require.

Thinking in official circles was however much more realistic. Officials had no doubt that the United Kingdom was serious and further that in the final analysis the interests of New Zealand farmers would go by the board if concern with them deemed likely to prejudice the United Kingdoms chances.

De Gaulle's veto in 1963 came as a great relief to New Zealand, although it was generally recognised that the United Kingdom would almost certainly make another attempt before very long. Nevertheless, although the events of these years did more than anything else to shake the confidence of New Zealand in the United Kingdom market as a permanent outlet for meat and dairy produce exports, agreement had been reached between the United Kingdom and five of the EEC countries (France entering a reservation) that New Zealand was in a "special position" and that arrangements to deal with the problems presented for her by United Kingdom membership would be needed. New Zealand negotiators regarded this as something of a triumph for their persistent efforts during the course of the negotiations to impress upon the United Kingdom and the EEC the "catastrophic" affects on New Zealand which the application of the common agricultural policy to the United Kingdom would have. Without belittling this achievement - and indeed no other policy than that followed would have had any support from New Zealand farmers - this result in my view was unfortunate and has seriously inhibited attempts to develop both alternative export products and alternative markets for the butter, lamb and cheese now being exported to the United Kingdom. Butter especially, for this product is the one about which concern has been greatest.

The way in which the "special position" would be handled has never been defined. Some officials and many in the farming industry seem to assume that the six could agree to New Zealands old relationship with the United Kingdom - unrestricted duty free access to the United Kingdom market - being continued. Others more realistically consider that at best it would involve no more than some form of compensating finance for a limited period. Whatever the view taken, the generally agreed official line appears to be that the best outcome can be achieved if New Zealand does not reduce her degree of dependence on the United Kingdom market. This sounds reasonable enough except that the probability of gaining anything more than a temporary respite can hardly be very high. Even if De Gaulle is no longer in command in France, it seems inconceivable that the Six would allow the United Kingdom - a major foodstuff importer - to join the EEC and not at the same time give priority to absorbing the expanding EEC meat and butter export surpluses.

The official line is however hard to combat especially now that De Gaulle has again vetoed the British application and that the United Kingdom entry guarantee to New Zealand still has at least five years to run.

Not all the pressures are in the direction of maintaining the status quo. Recent projections of the Food and Agriculture Organization about agricultural commodity production and trade in 1975 (and demand in 1985) are of considerable interest for policy purposes in New Zealand. The projections suggest that, of New Zealand's main exports, prospects are most favourable for meat and least favourable for milk and milk products. World commercial demand for beef and veal, and for mutton and lamb, is predicted to outrun supply. The world market should consequently be able to absorb predicted increases in production and indeed offers some prospects of price rises. For milk and milk products on the other hand, import demand in the main international market, the United Kingdom, is expected to fall and substantial export surpluses are predicted in Western Europe. In total, world production is forecast to outrun commercial demand by a significant amount. For wool the FAO suggests an increase in demand more or less in parallel with supply, but unfortunately the projections do not distinguish between coarse and fine wools. Furthermore, there are likely to be major increases in demand for meat, including mutton and lamb, from a wide range of markets. Significant import increases are forecast for North America, Southern Europe, the Soviet Union and Eastern Europe, Japan and for the developing economies.

The really difficult problem is that of dairy products, the projections indicating that present trends will lead to increased difficulties in marketing the output of the main exporting countries, with France and Germany, which in 1961/63 had a small import requirement, having a surplus of 330,000 tons butterfat equivalent in 1965 while the shortfall of British production will drop from 400,000 tons (1961/63) to 300,000 tons in 1975.

Even if the increase in European surpluses is only half as great as the projections indicate, and even if the United Kingdom does not join the EEC, the pressure of supplies on the United Kingdom market would be heavy and prices inevitably driven down to low levels. Furthermore, there is bound to be a scramble for whatever markets are available elsewhere - in some of the developing countries for instance, or in places such as the West Indies where New Zealand has been able to build up useful markets although with a lot of effort. But such competition would not be on the basis of economic prices but on the basis of export subsidies. It would be a competiton between Treasuries and New Zealand is not in a position to engage in that sort of activity. Forecasts of export prospects have also been made by A. Maizels and others in a recent articles in the National Institute Economic Review. The main results of interest to New Zealand are summarised below.

TABLE II

Projected Annual Rates of Growth of Consumption of Stated Products in the Main Industrial Areas, 1960-61 to 1975
(% a year, compound)

	U.S.A.	Canada	U.K.	EEC	Other Western Europe	Japan	Total
Meat	2.3	3.2	1.6	3.2	5.1	8.3	2.9
Butter	-0.4	0.3	1.6	1.8	1.3	8.4	1.2
Cheese	2.4	3.3	1.1	2.3	3.5	6.5	2.4
Wool	0.9	1.9	-0.4	0.5	0.9	2.9	0.9

These results are more optimistic than those of the FAO for meat but certainly more depressing for butter and wool. For each of New Zealand's main exports the growth in total demand is less than 3% per annum, for butter and wool only about 1%. Of special importance is that the United Kingdom market has the slowest growth prospects. The really bright spot is Japan with projected demand for each commodity above that of other industrial areas.

For dairy produce this is confirmed by a New Zealand study which suggests that by 1975 Japan will have an import demand for approximately two million tons of milk in spite of major programmes being undertaken to expand dairy output.[1]

The implications of these projections have yet to have much influence on New Zealand trade or production policy even in terms of direction. The expansion of traditional agricultural output at around 4% per annum remains the target objective as agreed at the Agricultural Development Conference in Wellington in 1964, but that objective was never translated into terms of product requirements. What should now be obvious is that even if New Zealand decides to continue its concentration on exports of pastoral products, much stronger efforts must now be made to cultivate the Japanese market which almost alone gives the prospect of becoming the alternative to the

[1] A.R. Frampton, "A Market Target for the New Zealand Dairy Industry" Lincoln College, Christchurch 1965.

United Kingdom. Some of the considerations involved in such a policy change are dealt with in a later section of this paper.

Market diversion, however, will not of itself be sufficient to overcome the problems which New Zealand now faces of chronic balance of payments disequilibrium, slow growth, and unemployment. A significant expansion of exports to Japan, to Australia or to North America will be possible only if New Zealand opens up its own markets to competing imports. Moreover, the dependence of New Zealand on a few primary products can be reduced only if her industrial structure is made considerably more competitive than it is now.

The importance of export income, currently around 25% of Gross National Product, is that much of New Zealand's manufacturing depends on imported raw materials, components and capital equipment for its continued operation. Some 82% of all imports in the year ended June 1966 were in these categories. Moreover, manufacturing accounts for about 27% of all employment compared with some 12% in agriculture. In terms of contribution to Gross Domestic Product, however, agriculture is still more important providing some 25% (including primary produce processing) as against 22% for manufacturing.[1]

Most New Zealand manufacturing is oriented towards the local market, less than 4% of output being exported. Apart from a few industries processing for export, most units are high cost and are fairly small with less than 3% of units having 100 employees or more although this group contributes nearly 50% of total added value.

Prior to 1938, industry was protected by relatively low tariffs but since then has had the benefit of import licensing imposed originally for balance of payments reasons. In recent years especially, import licensing has been used deliberately as a means of increasing the pace of industrialisation in order to achieve import substitution and to reduce the degree of dependence on foreign trade as well as to "provide employment".

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[1]Derived for 1964/65 from C.A. Blyth, "Strategic Factors in New Zealand's Economic Growth 1965-75" Wellington, 1965

In fact the degree of dependence on imports has not been reduced the ratio of imports to GNP having remained fairly constant at about 30% over the past 15 years.[1] The composition however has changed in that finished capital and consumer goods are now a much smaller proportion and components etc. a much larger proportion (70%) of total imports.

The policy of industrialisation to provide employment and to reduce import dependence has been accompanied in the post-war years by government expenditure policies aimed at improving welfare benefits and at providing the educational, health, transport and other services demanded by an increasing population. Until about the mid-fifties, these policies did not lead to serious balance of payments troubles because the increased volume of New Zealand exports plus rising world prices for meat, dairy produce and wool helped to expand export income sufficiently to keep the balance of payments deficits within limits that could be comfortably financed by private capital inflow and by government borrowing. These conditions did not last and with sharply falling export prices and rising import demands a severe balance of payments crisis was experienced in 1957/58 when the deficit rose to $NZ103 million and after some improvement in the next two years rose again to over $NZ100 million in 1961 and 1962. In the last two years the deficits have been $186 million and $NZ 205 million respectively and a further deficit of about $NZ140 million is forecast for the year ended March 1968.

The collapse of the wool market has been blamed by the Government for this situation which has entailed heavy external borrowing from the IMF and a variety of other sources. While the fall in wool prices was a precipitating factor, the Government must bear a large share of the blame for failing to take corrective action at least 18 months beforehand to control the rise of internal expenditure and the demand for imports when this course became clearly necessary. Indeed, the rise of Government expenditure by an average of 9% per annum for the three preceeding years must have been a major contributory factor to the increase in imports. Action was, how-

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[1] J. W. ROWE, "Import Reliance 1950-65"; N.Z. Economic Papers Vol. 1, No.1, 1966.

Also, A.D. Brownlie, "N.Z's Import Function" N.Z. Economic Papers Vol. 1. No.2 1966.

ever, finally taken in early 1967 by the removal of subsidies on foodstuffs, raising prices of certain government services, the imposition of increased sales taxation and the sharp curtailment of the rate of increase in government expenditure. The objective of these measures as stated by the Minister of Finance in his "Letter of Intent" to the International Monetary Fund is to achieve a balance on current account by June 1969.

Devaluation of the New Zealand dollar on 22 November by 19.4% could help materially in meeting this objective but the Government has yet to announce what additional steps it proposes to take to ensure that devaluation is used to improve the longrun position of the economy. The events of the past year however, have brought a much wider realisation than ever before that primary produce exports, heavily concentrated in a market that is not expanding, are not a sound basis for future development. At Government level too there is growing opinion that an essential part of the remedy lies in expanding industrial exports and in doing more to promote alternative markets for the traditional products, especially in Japan. It is not at all clear nevertheless that Government is prepared to take the main step that is now needed, namely, the removal of import licensing that has been in force for nearly 30 years.

III Trade Relations with Australia and Japan

As mentioned earlier, New Zealand policy is still primarily concerned with New Zealand's position in the United Kingdom market. Nevertheless special attention has been given in recent years to the expansion of trade with Australia and Japan as part of more general efforts to increase exports and to reduce reliance on the United Kingdom market. The following section briefly reviews New Zealand trade relations with these countries.

(a) Australia

Despite geographical proximity and similarity of historical and cultural background, trade relations between Australia and New Zealand have never been especially amicable. Various attempts had been made from time to time to improve trade conditions by the elimination of tariffs, granting special licensing treatment or the exchange of tariff preferences. But the history of trade relations between the two countries is more a record of conflict than of co-operation. This is rather less true of their relations in dealing with other countries in the GATT and elsewhere where it has been usual for New Zealand and Australia to consult closely together and to reach if possible a common position.

Co-operation in other fields, especially defence and foreign policy, has usually been much closer and it was from this side that the first formal attempts to collaborate in economic matters arose. The Canberra Pact of 1944 which embodied provisions for the development of commerce between the countries and for their industrial development "to be pursued by consultation and in agreed cases by joint planning" unfortunately turned out to be largely a dead letter, although irregular consultations on trade matters did take place.

Events in Europe in the late 1950's and movements elsewhere towards regional political and economic groupings reawakened interest in trans-Tasman co-operation and eventually, in August 1960, an Australia/New Zealand Consultative Committee on Trade was set up. Shortly afterwards discussions began on a New Zealand proposal for a free trade area arrangement covering forest products (an industry that New Zealand had developed in the 1950's) but this idea was rejected by the Australians as too limited and unlikely to be acceptable to the GATT. A wider arrangement covering not only forest products but items already traded duty free, as well as certain other items agreed by both sides was eventually signed on 31 August 1965. This Australia New Zealand Free Trade Agreement (NAFTA) as it stands at present, however, has only limited relevance to joint industrial development by the two countries. Its coverage is very narrow and is really confined to products which were already being traded. Only a few items of manufactured goods are included where there is some New Zealand industrial capacity. This reflects the bitter opposition of the New Zealand Manufacturers' Federation; and the Minister of Industries and Commerce has publicly stated that it is not the intention that any industry in New Zealand be damaged by the Agreement. The extensive safeguard clauses, many inserted to meet New Zealand fears, seem to be designed to ensure that the Agreement will never be allowed to promote by the normal processes of competition a more economic use of resources in New Zealand.

New Zealand has probably gained rather more than has Australia. The real benefit is that all pulp and paper products are included as well as most classes of sawn and dressed timber. Some agricultural products of interest to New Zealand are included, such as frozen vegetables, lamb, pigmeat and cheddar cheese. But Australia refused to include butter in the interests of protecting its own dairy industry.

The Agreement provides in general for duties to be reduced over a period of eight years and for products to be added at each annual review. Apart from this there is no firm timetable for extending the coverage in a way that would in a few years bring effective pressure on industries in both countries. One is forced to conclude that the Agreement does not indicate any change in the policies of either country as regards industrial protection.

Devaluation of the New Zealand dollar to parity with that of Australia and the consequential policies that must be followed for the long run improvement of New Zealand's economic structure could bring a major change of attitude in New Zealand. Devaluation has substantially improved the competitive position of New Zealand manufactured goods and has made the prospects of expanding manufactured exports to Australia considerably better than they were earlier. But it is still too early to say whether the Government will now feel confident enough to reject the opposition of the Manufacturers' Federation and to seek a substantial enlargement of the list of products covered by the Agreement. Again, much will depend on whether more general measures such as the removal of import controls now being strongly advocated by the Monetary and Economic Council of New Zealand, are taken within a short time.[1]

(b) Japan

The spectacular increase in New Zealand's trade with Japan referred to earlier has occurred mainly over the last six or seven years. New Zealand exports consist principally of agricultural and forest products - wool, meat, dairy products, casein, pulp, paper and timber. Japanese exports to New Zealand cover a wide range of manufactured articles and raw materials including optical goods, textiles, electric and other machinery, vehicles, steel and chemicals. The value of

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[1] A more detailed analysis of the Agreement is contained in E.W. Holmes, "Freer Trade with Australia?" N.Z. Institute of Economic Research, Wellington, March 1966.

New Zealand exports has risen from $NZ11 million in 1957/58 to $NZ63 million in 1966/67. Imports from Japan were $NZ5 million and $NZ44 million respectively for the corresponding years.

The very high rate of economic growth in Japan over the past ten years would be the chief reason for this expansion of trade. Rapidly rising incomes and changing patterns of food consumption have led to an even faster rate of increase in Japan's import requirements of wool and protein foodstuffs which New Zealand is particularly well placed to supply. Furthermore, domestic production in Japan has been unable to meet these demands. The increase in New Zealand imports from Japan reflects the expansion of New Zealand industrial output and also the displacement of other suppliers such as the United Kingdom from the New Zealand market. The growth of trade has in addition been materially assisted by the Trade Agreement between the two countries concluded in 1958 and subsequently amended in 1962 (the most important amendment being New Zealand's withdrawal of her application of Article 35 of the GATT to Japan). The Agreement provided in the main for the application of most-favoured-nation treatment but in addition certain concessions on products of special interest to each party were negotiated. The Japanese tariff on mutton and lamb, for example, was bound at 10%; but these concessions and others subsequently negotiated in the Kennedy Round are in accordance with the GATT extended to all GATT members. But apart from Australia this is of little practical significance to New Zealand.

It seems fairly clear that there is considerable room for further growth of Japan/New Zealand trade. The increase in demand in Japan for meat and dairy produce is rapidly outstripping the capacity of the domestic industries to supply. For meat, the FAO projections mentioned earlier suggest an import requirement in 1975 of 171,000 tons beef and veal and 76,000 tons of mutton and lamb compared with net imports of 5,000 tons and 32,000 tons respectively in 1961/63. New Zealand exports to Japan of mutton and lamb alone area, however, already in excess of 60,000 tons with demand still rising. Exports so far have been comprised largely of mutton for manufacturing purposes but the prospects of stimulating retail sales of both mutton and lamb are considered by the New Zealand meat trade most promising. For dairy products, trade is restricted at present by import controls in Japan but even so a deficiency of some 80,000 tons (butterfat equivalent) in 1975 (as projected by FAO) compared with net imports of 2,000 tons in 1961/63 indicates the volume of trade that may be possible.

The prospects for Japanese exports to New Zealand are less clear. Most consumer goods are subject to import licensing. No imports are permitted where the item concerned would compete with domestic production in New Zealand, while for other goods (such as cameras, toys, chinaware, etc.) imports are being restricted by licensing as well as by the general fall in internal expenditure as a result of recent measures to reduce the level of economic activity in New Zealand. Moreover, the recent devaluation has put Japan in a less competitive position vis-a-vis the United Kingdom. On this latter point the question of differential tariffs is of some relevance. For many items, cars for example, the margins of preference in favour of the United Kingdom are very substantial, well above the margins which New Zealand is legally obliged to accord in terms of the United Kingdom/New Zealand Trade Agreement of 1959. These could be reduced to the advantage of Japan (as well as to the advantage of EEC and other countries to whom m.f.n. rates of duty apply) but to the disadvantage of the United Kingdom. Once again there is some reluctance to touch these non-contractual preferences mainly for fear that to do so would provoke the United Kingdom into retaliatory action either by expanding the present butter quotas in favour of New Zealand's competitors in the United Kingdom market, or by taking a less firm attitude about New Zealand's position if and when negotiations with the EEC are resumed. In addition, with New Zealand's eyes still firmly fixed on the United Kingdom market, there is a strong disposition not to take any action on questions such as the non-contractual preferences because, if the United Kingdom has not become a member of the EEC by 1972, New Zealand would wish to secure a further extension of the guaranteed rights of access to the United Kingdom market which are due to expire in that year. Finally, there is the more general point mentioned already, that a significant relaxation in Japanese import restrictions on dairy products will not be made, it is feared, unless New Zealand is prepared to go much further in reducing the licensing and tariff barriers to Japanese imports than she has so far been prepared to contemplate. For this again raises the very difficult issue of New Zealand's policy of industrial protection.

IV Foreign Policy and Foreign Aid in Asia

The economic forces which seem to be driving New Zealand reluctantly toward much closer trade and economic links in Asia and the Pacific are, if anything, assisted by the degree of involvement already reached in political and security relationships. For most of her history New Zealand had relied absolutely upon Britain to provide protection against external attack. The anxieties she expressed from time to time about expansionist ambitions in the Pacific in the 19th century of Russia, France and Germany, and after 1919, of Japan, were more about the time it might take for the British Navy to arrive than about the ability or willingness of Britain to defend her. In many ways the feeling of attachment was stronger on the New Zealand than on the British side. Most immigrants were of British stock and retained close family and business ties with the "Old Country" or "Home" (expressions still used by many among the older generations in New Zealand). There was a common language, a common sense of destiny and purpose. New Zealand regarded itself as an outpost of England and of Empire and New Zealanders, with an alacrity that seems incredible nowadays, volunteered to assist England in wars of colonialist expansion as in South Africa or in more general conflicts such as the Great War of 1914-18. Even in 1939, the then Prime Minister, Mr. M.J. Savage had no doubt that he was expressing the sentiments of the country in immediately declaring war on Germany at the same time as did the United Kingdom and in observing with pride that, "where British goes, we go. Where Britain stands, we stand. "Sycophantic sentiment though this might be, it did charactise, by and large, the nature of New Zealand's "foreign policy" up to that time.[1] Independence of thought and action was seldom the case and indeed largely irrelevant.

The Second World War brought a more permanent involvement of the United States in the Asian and Pacific region and also brought a clearer appreciation by New Zealand that she must in future look to the United States rather than to Britain for her protection. This realisation was given practical expression in the ANZUS Treaty of 1951 bet-

[1] This broad generalisation overlooks some degree of independence displayed in the League of Nations in the 1930's.

ween the United States, Australia and New Zealand, but neither this nor for that matter New Zealand's involvement in the Korean War in 1950 (as a United Nations member) indicated any feeling of special involvement in Asian affairs. The Australian attitude at this time was very different.

In the years that followed a number of steps were taken, each pragmatic and valid enough in its own right, which collectively resulted in the much stronger sense of involvement and responsibility which now marks New Zealand foreign policy as regards Asia and the Pacific. In 1954, sharing with Australia, the United States and a number of countries in Southeast Asia a growing concern with communism following the Geneva Accords, New Zealand, in participating in SEATO, became for the first time associated in a regional defence agreement with Asian countries. New Zealand also became associated at this time in Commonwealth defence arrangements in Malaya involving the maintenance of New Zealand military forces there. It was an entirely natural development, therefore, that New Zealand should agree to transfer early in 1955 its wartime commitment from the Middle East to Southeast Asia. With this increasing security interest came an expansion of New Zealand's diplomatic representation. Prior to 1955, when the New Zealand Commission was established in Singapore New Zealand had no diplomatic post in the Pacific area apart from Tokyo and Canberra. Today, New Zealand is represented in most countries in Southeast Asia and certainly is more generally represented there than it is in Europe.

The growth of a close security interest in the area has been paralleled by increasing involvement in the problems of economic development. In 1947 New Zealand became an associate member of ECAFE and in 1950 joined with other Commonwealth countries in the Colombo Plan. (The Minister of External Affairs claimed at the time that New Zealand was "too poor" to participate but this pronouncement met with strong public condemnation.) But in both cases, however, it cannot be said that at the time the decisions to take part implied any sense of special concern with Asia. Membership of ECAFE was simply an aspect of New Zealand's general support for the United Nations Organisation and in any case there was no other regional United Nations body to which she could logically belong. New Zealand did not become a full member of ECAFE until 1962, but significantly enough, it was at her own request.

Again, participation in the Colombo Plan was more from general Commonwealth solidarity and humanitarian grounds and the desire to promote economic and social progress as a means of combatting communism. Had the Commonwealth members been located primarily in South America, New Zealand would still have supported any similar plan on the same grounds. The lack of special concern is perhaps neatly illustrated by the fact that, with sound economic logic but little political touch, it was proposed to divide up the initial allocation of $NZ2 million among India, Pakistan and Ceylon and simply make a transfer of sterling funds to these countries without reference to projects or programmes. This idea was soon abandoned.

In the initial phase of the Colombo Plan only independent members of the Commonwealth were members so this effectively meant that only India, Pakistan and Ceylon could be candidates for aid. Moreover, these countries had competent administrators and usually well-planned projects to which assistance could be quickly granted. Then again there was the common bond of the English language and familiarity with British administrative machinery which made the problems of extending capital assistance to and instituting technical assistance programmes in India, Pakistan and Ceylon relatively easy to deal with. These are the principal reasons why, when Colombo Plan membership was extended beyond Commonwealth countries in South and Southeast Asia, very little New Zealand aid went to these new members. But other factors led, after 1956, to a marked shift in the distribution of New Zealand's Colombo Plan aid. First, the total aid allocation of $NZ2,200,000 for both capital and technical assistance had remained constant at this level since 1950, and it was reduced to $NZ2,000,000 at the time of the 1958 balance of payments crisis and has not since been increased. Secondly, with more members it has been thought desirable for presentational reasons to allocate some assistance to every member. Thirdly, in order to reduce the "burden" of aid on New Zealand's foreign exchange resources the emphasis has been shifted away from capital assistance grants to technical assistance - largely that of training personnel and students in New Zealand. This is not a form of assistance which India, Pakistan and Ceylon have wanted from New Zealand. Fourthly, and of most importance, the development of security arrangements with Malaysia, Thailand and Vietnam has led also to a desire to give special attention to these countries needs in economic problems, thus to demonstrate that New Zealand's interest goes further than mere military involvement. While one may deplore the fact that political considerations enter into the allocation of aid, even in the case of a country as insignificant on the world scene as New Zealand, it is plausible to suggest that in the absence of this security interest, expenditure on aid may well have been reduced still further in recent years when New Zealand has been in serious external financial difficulties, although to a large extent of her own making.

Unlike many other countries, however, New Zealand has not sought overtly to tie its aid to the purchase of New Zealand goods. Aid has almost wholly taken the form of direct grants of foreign exchange in the case of capital assistance, or the provision of the services of experts or training in New Zealand. Capital assistance grants have always been in respect of particular development projects. For these it has been a frequent practice to provide also the services of technical experts at the planning construction or operational stage. As a matter of policy New Zealand prefers to support projects to which a New Zealand expert can be assigned at some stage. Large projects tend to be avoided partly because the amount now available for either technical or capital assistance outside New Zealand is small and because the larger the project in relation to the small amount of New Zealand assistance, the less is the effective control that New Zealand can maintain over the expenditure of any grant. New Zealand has also tended to concentrate its assistance on certain types of projects for which it believes it has special expertise. Thus agricultural education, trade training and technical education, medical and health services have been prominent in New Zealand's aid programme. A good deal of effort has gone into "institution-building" in the countries being assisted: not only through the provision of finance for buildings and equipment but also in the planning of curricula, organising staff and attempting to ensure that the projects are established on a self-perpetuating basis. The development of dairying has received special attention. Most of such aid has been extended to India and Ceylon where milk is a traditional part of diet. Little attention has been given to milk production problems, the assistance being generally confined to the establishment of processing and distribution facilities.

For these latter projects, some assistance has been given in the form of New Zealand manufactured dairy machinery and equipment and in addition New Zealand has been able through this type of aid to secure contracts for the supply of milk powders for manufacturing purposes. Naturally enough, aid for milk schemes has the strong support of the New Zealand Dairy Board which sees trade possibilities emerging in the long term from the development of the milk-drinking habit.

In general, however, New Zealand has refused so far to link aid with trade and has refused also to entertain suggestions that in order to lighten the aid burden aid should be given in the form of foodstuffs. New Zealand does not produce foodstuffs of the kind or in the form required in most of the developing countries apart from butter which would in any case need conversion to butter-oil for cooking purposes. Withdrawal of any quantity of butter from the United Kingdom market would not result in any rise in prices for the New Zealand Product since the gap would be quickly filled by European surpluses. The recipient country is better off, in the New Zealand view, by having available the equivalent amount of foreign exchange which it can use to best advantage. Moreover, food aid is not directly connected with economic development and may indeed damage the prospects of increasing domestic agricultural production.[1]

Most of New Zealand's aid expenditures have been made on a bilateral basis, but some multilateral or multinational schemes, the Indus Waters Project, the Mekong River Committee and the Asian Development Bank, have been supported. In addition New Zealand has over the years consistently supported multilateral aid programmes of the United Nations. Aid has also been extended to African countries under the Special Commonwealth Aid to Africa Plan, partly from Commonwealth interest and the usual humanitarian reasons and partly to be seen to be doing at least something for a region which has become much more important in world political affairs in recent years. But New Zealand's primary aid interests remain in Asia and the Pacific. The fact that aid expenditures in the Asian area have failed to expand and have not been maintained even at their original level is not from lack of enthusiasm on the part of the Department of External Affairs which would certainly like to see this aspect of New Zealand's relations with Asia considerably extended. But it is very

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[1]M.J. Pope has argued convincingly that for New Zealand food aid is no less burdensome than a grant of foreign exchange. "On the Economics of Foreign Aid from the Donor's Viewpoint" in G.J. Thompson "New Zealand's International Aid" Wellington, 1967.

difficult to persuade Treasury officials and Government Ministers faced with almost perpetual financial crisis and balance of payments problems that charity does not necessarily begin at home. Perhaps too this simply reflects once again the lack of any real sense of involvement in the problems of Asia. In this also New Zealand differs from Australia.

V Summary and Conclusion

In this final section I shall attempt to draw together the main points of this paper and to suggest their implications for the future development of closer economic ties with other countries in the Pacific perhaps in the form of a Pacific Economic Community as has been suggested by Professor Kojima or in a looser arrangement.

The pervading influence on New Zealand's approach to foreign policy in the past has been its economic and political dependence on the United Kingdom. This developed quite naturally from the way in which New Zealand was first colonised by Britain - the transplantation of British people, British political, administrative and educational institutions and British culture generally. Moreover, New Zealand's economic development, in particular its specialisation in pastoral produce for export, depended on the British policy of free trade. In matters of defence, dependence on Britain was virtually inescapable since New Zealand was incapable of defending itself and there was no other country on which New Zealand could or was prepared to rely. Being small and remote defence was not of any real direct importance; it was more important to assist where possible in preserving "Pax Britannica" even though this meant sending troops thousands of miles from her shores to fight in Europe on in the Middle East.

Dependence on Britain was readily accepted as the correct policy for a country in New Zealand's position. There were many advantages. The United Kingdom seemed a limitless market for New Zealand foodstuffs and certainly enabled New Zealanders to achieve a high standard of living. Further, dependence meant also (and this was strongly reinforced by bulk purchasing arrangements during the war and post-war period) escape from uncertainty and escape from the need to "waste" resources in continuous market development and the need to search for new products. And, finally, under these conditions of security in external trade and politics, New Zealand could to a large extent ignore the outside world and push ahead with the creation of its own special Polynesian brand of the Welfare State.

It is only in the last decade that New Zealand has begun to realise that this type of policy rested essentially on the commanding position that Britain once held in world politics and in the world economy. But this has long since ceased to be true. New Zealand has been obliged to accept that in defence and security Britain is no longer relevant to her and that, with security in Southern Asia now a primary consideration, she must in her new relationships with the United States and others in the Pacific play a more positive role than was necessary in the past in relation to Britain.

In trade and commercial policy too, New Zealand faces an entirely new situation. Continued expansion of export income is essential to internal economic development and the maintenance of full employment. The United Kingdom, however, can no longer continue to absorb most of New Zealand's increased meat and dairy produce exports. The United Kingdom wishes to reserve any increase in domestic consumption for her own agricultural industry to meet, and in any case would like to adjust her methods of support more in line with the common agricultural policy of the EEC. Outside the United Kingdom there are few markets available for lamb and dairy produce because of widespread protection to domestic agriculture, low incomes or taste barriers, except possibly at prices which imply a much lower rate of economic growth than New Zealand has achieved in the past. Accordingly, a development policy based on continued expansion of output of traditional products is highly questionable. Furthermore, New Zealand has made things worse for herself not only by building up a highly protected, high-cost industrial structure oriented primarily towards the domestic market but also by internal inflationary policies and has now to deal with serious, chronic balance of payments difficulties.

The latter problem has been approached with any resolution only in the past year with the introduction of severe fiscal and monetary restraints to dampen down the demand for imports. Internal deflation is likely to cure the balance of payments problem only at the expense of much higher unemployment than that to which New Zealand has been accustomed in the past 25 years. The longer term position of the New Zealand has yet to be approached with similar resolution. Devaluation of the New Zealand dollar is seen to offer an excellent opportunity for major policy changes but there is a strong inclination at Government level to put these off for as long as possible for they are bound to meet with much opposition from manufacturers and farming interests as well as from trade unions.

In external economic policy the stated objective of securing long term growth of export income of 4% p.a. is unlikely to be achieved through continued expansion of the traditional exports of meat wool and dairy produce to the United Kingdom market. New Zealand must now move into the rapid development of exports of manufactured goods both because it is desirable to broaden the export range and be less dependent on fluctuating prices of a few products and because in the longer term manufactures are likely to show the faster growth rates in world trade. Two main lines of policy are suggested. The first is that of securing a much better use of available resources by opening up manufacturing industry in New Zealand to international competition. This means in particular the abandonment of import controls as a means of protection. The second and connected point is that of greatly intensifying efforts to expand markets for lamb and dairy produce in the Pacific Region. In effect this relates principally to Japan and to Australia but both Canada and the United States need not be left out of account.

A Pacific Economic Community or even a looser framework of co-operation could be of special relevance to the basic structural changes and indeed changes in mental attitudes which New Zealand must now make as part of its adaptation to trading conditions quite different from what has been the case in the past. Some elements of such a co-operative framework already exist in the trade agreements between Japan and Australia and New Zealand and in the Australia/New Zealand Free Trade Area. The latter must be regarded still as - from the New Zealand side at least - a first trembling step; but even if, following devaluation, New Zealand is able significantly to expand the range and volume of its manufactured exports to Australia it must be doubted whether for the longer run it will be sufficient and desirable to gear the restructuring of the New Zealand industrial sector to an economy whose own industries need to be made more competitive in world terms. Since changes must be made by New Zealand it would be well to cast them right from the start in the much broader framework which a Community could provide.

Again, so far as Japan is concerned, the expansion of New Zealand exports of meat and dairy produce to that country will require a change in Japanese attitudes towards the protection of domestic industry. Within the framework of the Japan/New Zealand Trade Agreement there is undoubtedly scope for tariff concessions by New Zealand beneficial to Japanese industry. But these are likely to have more force in bringing about required changes in protectionist attitudes if they are accompanied by concessions from others and are seen to be important in terms of general Japanese economic and political objectives in relation to Pacific and Asian affairs.

A similar point is relevant in the New Zealand case. The changes that New Zealand must make in its industrial and export structure and in its relationships with the United Kingdom will not find ready acceptance by those groups in New Zealand whose interests or prejudices are likely to be affected. These changes are more likely to become acceptable if made in the context of a broader grouping that a Pacific Community would provide. New Zealand still retains a strong belief in the virtue of multilateral trading relationships not least of the protection they can give to small countries with little bargaining power. Hesitation and apprehension in New Zealand about closer trade ties with Australia or with Japan could be reduced if these closer ties could be developed within a grouping that included Canada, the United States and possibly also some of the countries of ASPAC. On general grounds too it would seem desirable that any such development should proceed within the framework of the GATT which has done so much to expand world trade over the past twenty years. Disillusionment about GATT in New Zealand is general but she may yet find that the progress that has been made in reducing industrial tariffs and trade barriers the most relevant to her future progress.

More broadly still, New Zealand clearly has the strongest interest with others in the security stability and economic growth of the developing countries in Asian and the Pacific. Despite her present pre-occupations, it would be untypical of New Zealand to adopt an attitude of standing aside from these problems. New Zealand cannot play the part rightly to be expected of her unless her own economy is strong and resilient. Co-operation with other developed countries within the Pacific can help to bring that about.

Chapter 4

THE PROSPECTS OF THE ECONOMIC INTEGRATION OF JAPAN, AUSTRALIA AND NEW ZEALAND

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I Economic Policy in Australia and New Zealand

Although Professor Castle has already dealt with economic policy in New Zealand and although my former colleagues at the Australian National University will shortly be assessing Australia's economic policy in the Pacific, there are several points I should like to make prior to discussing the prospects of establishing a Free Trade Agreement between Australia, Japan and New Zealand. I intend to list briefly the major policy objectives of the two Australasian economies; to pose some questions suggested by these objectives; to appraise briefly the success of the policies used to secure the given ends; and, finally, to put forward alternative policies which I believe the two countries might better pursue.

(a) Policy Objectives

There may be some argument about relative importance, but most people would agree that the major objectives of economic policy in Australia and New Zealand are: the full employment of a growing workforce, rising per capita incomes, an equal distribution of incomes, and stability of incomes brought about by each country regulating the market mechanism internally and endeavouring to become less dependent upon international trade. Definitions of full employment vary between countries (as they do between Australia and New Zealand) but unemployment in excess of 1% of the workforce would be considered serious by both countries and in excess of 2% would be regarded as politically disastrous. Economic growth which has become synonymous with manufacturing development, has been fostered by a high tariff structure in Australia and by the use of tariffs and the widespread application of import licensing controls in New Zealand. An equal distribution of the national products is sought, especially in New Zealand, by a highly progressive income tax structure. Stability of incomes internally has been achieved by a network of licensing controls and by restrictions on competitive forces. For instance, in both countries one of the criteria used by arbitration system in setting wages is the general prosperity of the economy rather than the productivity of labour in the industry concerned. In both countries radio, television, the sale of liquor, transport, the distribution of motor spirits and many other productive activities are subject to licensing and entry to the industries is controlled. Finally, reduced dependence upon overseas trade is sought on the export side by diversifying markets and the range commodities exported and, on the import side, by the development of import competing industries which, being mainly of a manufacturing character, are supposed also to promote economic development and make more certain the attainment of full employment.

These policy objectives raise a number of interesting questions. Does the high priority accorded to full employment (as defined by Australia and New Zealand) hinder rather than assist the economic growth objective? That is to say, making use of the compensation principle, could everyone be better off, even though more people were unemployed? Why should manufacturing development be regarded as the best way of achieving economic growth and is an aggressive protectionist policy the best means of ensuring industrial development? Is it possible that a less equitable distribution of the national income may provide sufficient incentives to an important section of the workforce, to make everyone better off? To what extent does the quest for stable incomes have harmful secondary effects on economic efficiency and to what extent does the continued reduction of dependence upon international trade reflect social and political immaturity rather than evidence of maturing nationhood?

(b) Some Common Problems

These questions must await another time and place for an answer. The success or otherwise, however, of each economy in attaining the above policy objectives does raise several issues not unrelated to a proposal for regional integration. First, the rate of economic growth in Australia and New Zealand has not been high when compared with that of other more advanced economies. For the period 1954-55 to 1963-64, New Zealand recorded an annual average rate of increase in productivity of 2.1% and for a similar time period the comparable figure for Australia was 2.2%. These productivity growth rates were exceeded, in some cases considerably, by the majority of advanced economies.

Secondly, neither country has proved markedly successful in reducing its dependence upon international trade. To some extent export diversification has succeeded but more in the way of developing new markets than in diversifying the type of products which are exported. Table I compares the exports of the two economies for the years 1953-54 and 1963-64 and shows, despite Australia altering the commodity composition of its output of primary produce and achieving a relatively spectacular increase in exports of manufactures, that both countries still remain heavily dependent upon exports obtained from the primary sector. In Australia the export of grains, meat and wool comprised 59% of total exports in 1964-65; in New Zealand in the same time period exports of wool, meat and dairy products accounted for 87% of total exports.

In itself the high dependence of both economies upon a narrow range of primary product exports (which reflects the strong comparative advantage of both countries in these lines of production) is not disturbing, but it becomes so when taken in conjunction with the increased tendency towards agricultural protectionism in the industrial nations, the continuing threat to wool by synthetics production and the impending threat of the United Kingdom's entry to the E.E.C. Relatively speaking, all these problems have more serious implications for New Zealand than for Australia.

What of the policy of import substitution? Table II shows that imports as a percentage of gross national product have in Australia displayed no discernible trend while the apparent reduction of the import ratio in New Zealand is influenced by the widespread use of import licensing controls (which were also in force in Australia until 1960).

The value figures, moreover, understate the real dependence of both economies upon imports because in the time period under review import prices have risen much less than have domestic price levels in the two economies.

There are many reasons why the import ratios have failed to fall significantly but probably the major causes have been the spill-over of unsatisfied import demand and the increasing dependence of a number of small, import-competing industries on imported raw materials, semi-processed products and capital equipment. Spill-over effects induced by import licensing have either caused the demand for decontrolled imports to rise or, by generating inflationary pressues, they have made expansion difficult for import-competing industries using a larger proportion of domestic materials. At the same time, consumers have reacted to rising domestic price levels by switching their demand back to relatively cheaper imports.

Table III, which classifies imports in the two economies according to commodity type, shows that in 1964-65 some 75% of the imports of each country comprised producers materials for use in manufacturing, or capital equipment. Only 12% of the total import bill in New Zealand and 15% of the total import bill in Australia could be classified with certainty as final consumer goods; the remainder are made up of unclassified commodities, defence expenditure, fuel and lubricants, etc.

Thirdly, the failure of the import ratio to fall significantly over time and, indeed, to rise in real terms suggests that not only have policies of import replacement proved unsuccessful but that the major policy objective of full employment may itself be threatened. Providing export receipts are buoyant both economies can maintain the flow of imports required to maintain full employment production. In times of crisis, however, ~~the extent to which~~ the extent to which the flow of imports can be sustained depends upon access to overseas borrowings and upon the extent to which foreign exchange reserves have been built up in favourable years. In the event that neither of these sources of foreign exchange prove adequate, the real limitations of a policy which has encouraged highly import-dependent manufacturing industries becomes apparent.

Finally, the generous protection afforded the manufacturing sector in each country has fostered numerous, small-scale, high-cost industries which have hindered increases in productivity and have given rise to considerable misallocation of resources. Unfortunately, few attempts have been made to quantify this latter cost, although some valuable work has been done recently by the Committee of Economic Enquiry in Australia (1, Vol. II, p 74 - 91). Their analysis suggests that the subsidy equivalent of the tariff in Australia on factory products was equivalent to about 6 - 7% of the value of the gross national product in 1961-62. Quite apart from any statistical bias this estimate is, of course, no more than an approximation of the cost of protection in Australia because without the tariff the whole nature of the economy, the distribution of the national income and the level of incomes would change.

(c) Alternative Policies

An alternative policy which Australia and New Zealand might follow would be to allow manufacturing industry to develop in accordance with each country's comparative advantage. Such a policy, which could be implemented by reducing barriers to trade on a most favoured nation basis and by appropriate exchange rate adjustments (if required), would have two major beneficial effects. By exposing manufacturing development in the two countries to competitive conditions it would increase efficiency and, by altering the pattern and nature of industrial investment and output, it might lead to the establishment of export industries whose unit costs would be reduced because of economies of scale.

The standard objection to such a policy is that the level of manufacturing output could not be sustained and that full employment and economic growth would be threatened. This objection, in my opinion, ignores the fact that there must be some combination of exchange rates and monetary and fiscal policies which would ensure full employment production in the two economies. It also fails to recognize that both Australia and New Zealand have relatively large and established manufacturing sectors which, given an exchange rate appropriate to full employment, make it far from evident that manufacturing output would contract. It may even expand. This point is irrelevant, however, in that provided full employment is ensured, and provided production follows each country's comparative advantage, the actual pattern of production is unimportant. In so far as genuine infant industry opportunities exist these could be dealt with by commercial policy.

The measures outlined have two important defects. First, they ignore the strong political position of vested producer interests. Secondly, they do not allow for the major trading problem which confronts the Australasian economy: the extensive protection accorded primary production in the economically advanced nations. Agricultural protectionism, which is to be found in its most drastic form in the E.E.C., the U.S.A., and, to a lesser extent, Japan, virtually excludes primary producing nations from the markets of the protecting countries, and, as a result of dumping, ruins other commercial markets.

In these circumstances Australia and New Zealand should use any most favoured nation reduction in their own protection of manufacturing industry, to secure free entry for their own primary products into the protected markets of Europe, the U.S.A. and Japan. It is improbable, however, that any concession which Australia and New Zealand might offer would achieve a corresponding relaxation of controls on trade in primary products. Most countries as members of G.A.T.T. are bound by most favoured nation clauses in their commercial treatment of other countries and what would, therefore, be a quantitatively small concession on the part of Australia and New Zealand could require a considerable structural change in the advanced industrial countries.

In these circumstances, Australia and New Zealand might do well to seek entry to some regional trading area where access was guaranteed for their primary products and where each might pursue a more rational development of manufacturing industry. If the United Kingdom were to enter the E.E.C. and if no reduction were achieved in the world level of agricultural protection, such a policy would become virtually mandatory. Even if the United Kingdom does not enter the E.E.C., there is still much to be said for seeking access to a larger trading area, providing United Kingdom products are not discriminated against in Australia or New Zealand markets. In particular, because of the increasing importance of trade relations with Japan, it may be that the interests of Australia and New Zealand would be best served by seeking some form of integration with the Japanese economy.

II Some Characteristics of a Japanese - Australian New Zealand Free Trade Area - (JANFTA)

While aware that a mere recitation of facts and figures concerning market size and trade relations provides no substitute for a detailed analysis of the costs and benefits of integration, such information is required for background material. Unfortunately, the most recent statistics were not available, but earlier estimates given below do give some indication of market size and the importance of trade to the three countries.

(a) Size of the market

In 1965 the total population of the three countries was approximately 115 million which is 35 million less than the population of the European Economic Community immediately prior to its formation. In 1965 Australia's Gross National Product was US$21,587 million, Japan's G.N.P. US$84,324 million and New Zealand's G.N.P. US$3,933 million giving a G.N.P. for the entire area in 1965 of approximately US$110,000 million. On a per capita basis the relevant figures are Australia US$1,900, Japan US$861 and New Zealand US$1,490 which gives an average per capita income for the area as a whole of US$981 v (II). In real terms this figure compares favourable with that of the E.E.C. countries in 1955 (measured at current prices).

Figures relating output of coal and steel and electric power in the three economies give some further indication of market size (especially when these figures are compared with those of the E.E.C. countries in 1955). In 1965 the Area produced 83 million metric tons of coal (Australia 32 million, Japan 50 million, and New Zealand 0.7 million); 238 billion kilowatt hours of electricity (Australia 35.7 b. kwh; Japan 192.1 b.kwh, New Zealand 10.6 b. kwh); and 46.7 million metric tons of crude steel (Australia 5.5m. tons, Japan 41.2 m. tons) v (II). These figures contrast with levels of output in the same basic industries in the countries which were to comprise the E.E.C.: coal (1954) - 242 million metric tons; electricity (1955) 153 billion kwh; crude steel (1955) - 44 million metric tons (12,1-2 9).

(b) Trade Relations

Trade relations between the three countries who are all signatories of GATT are defined also in three international agreements: the New Zealand - Australia Free Trade Area Agreement, the New Zealand - Japanese Trade Agreement and the Australian - Japanese Trade Agreement. The first of these agreements is reviewed in some detail elsewhere in this paper. The main effect of the others is to establish a full GATT relationship which involved Australia and New Zealand renouncing the application of Article XXXV of the GATT which both countries had previously invoked.

International trade has always been important for the three countries and in 1965 exports as a percentage of gross national product in the area as a whole were 11% (Australia 14%, Japan 10%, New Zealand 21%). This compares with a figure of 20% for the E.E.C. countries in 1954.[1] Table IV which makes use of the notion of trade intensity shows that each of the three countries is now exporting more to the other two than might be expected from the share of the importing countries in total world imports. There is also a tendency for trade between the three countries to increase in relative importance. Between 1955 and 1965 Japan's export (f.o.b.) to Australia and New Zealand increased from US$63 million to US$375 million - an increase of approximately 600%. In the same time period exports (f.o.b.) from Australia and New Zealand to Japan increased from US$170 million to US$550 million - an increase of over 300%.

Despite the fact that Japan has now displaced the United Kingdom as Australia's major export market, that Japan is New Zealand's third largest export market and that Australasia was in 1964 Japan's third largest export market (ranking behind Hong Kong and the U.S.A.), Table V shows that in terms of the total trade of the three countries, intra-area trade is not very important. In 1965 the Area took only 23% of Australia's exports, 4.5% of Japan's exports and 9.8% of New Zealand's exports. On the import side the Area counted for 11.2% of Australia's imports, 7.6% of Japan's imports and 25.1% of New Zealand's imports. Any argument in favour of the formation of a free trade area, therefore, must rely on the likelihood of a very considerable increase in the volume and value of trade between the three countries.

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[1]The notion of trade intensity was first used by Professor A.J. Brown in (6) and has more recently been used by Professor K. Kojima (7). It indicates whether or not the jth country is exporting more (or less) to a particular country (the ith country) than might be expected from that country's share in total world imports. Thus in the table a figure greater (or less) than 100 indicates that the jth country is exporting more (or less) to a particular country than might be expected from that country's share in total world trade.

Tables VI, VII, VIII, and IX give a broad indication of the commodity composition of trade. As might be expected trade between Australasia and Japan is characterized by the export of raw materials and primary products and by the import of a wide range of manufactured products. In 1965 the export of wool to Japan accounted for more than 50% of total Australasian exports and other major exports were coal (approximately 10%), grains and cereals, sugar, meat and dairy products and ores and concentrates. It should be noted that the present and future role of iron ore exports from Australia to Japan is not revealed in these 1965 figures; by 1970 contractual agreements indicate that Australia will be exporting at least A$180 million per annum of iron ore and that the majority of this ore will be destined for Japan (13, 56-57).

Imports into Australasia from Japan make up a wide range of industrial products, the majority of which are subject to high tariff rates or to import licensing control. The most important categories of imports in 1965 were metals, metal manufactures and machinery (approximately 40% of total imports), textiles (26% of total imports), chemicals and drugs, etc.

As far as trade between Australia and New Zealand is concerned this was reviewed in greater detail above. For the most part, as Tables V and VI indicate, it is characterized by the export of sundry primary products and newsprint from New Zealand and by the import into New Zealand of a wide range of industrial commodities (New Zealand is Australia's largest market for manufactured exports.) The most important category of import is iron and steel products (approximately 20% of total imports) and motor vehicles and motor spirit (slightly less than 20% of total imports).

(c) Levels of Protection

Finally, what of the height of the general tariff levels of the member countries. There are a large number of problems which confront anyone attempting to measure the degree of protection offered by a country's tariff structure, but, generally speaking, one can gain some indication of the height of tariff structures by taking an average of the ad valorem duties payable of the various tariff classifications (which involves weighting according to the ingenuity with which imports have been subclassified) or by weighting each tariff classification by trade values (which leads to the paradoxical result of a low weight for a highly protective tariff.) The former method has been selected to compare the tariff structures of Australia and Japan. No similar exercise is attempted for New Zealand because of the severe application of quantitative restrictions in that country.

Only those tariffs in excess of 12½% ad valorem have been calculated as below this percentage figure is was felt that duties were levied for revenue purposes. In the case of Australia specific duties have been converted to an ad valorem equivalent; no such conversion has been attempted for Japan. The results show that in Australia in 1962-63 30% was the average nominal rate of protection available to Australian industry (1, Vol. II, L127) and that in Japan in 1964 the average nominal rate of protection was approximately 20%. One could, therefore, classify Japan as a low tariff country and Australia and, probably New Zealand, as countries in which the rate of protection was high.

III JANFTA - The Prospects

(a) Why Trade Has Increased

The tendency for trade between Australia, Japan and New Zealand to grow at an accelerated rate is of recent origin and it is instructive to enquire why this increase has occurred and why trade has remained so sluggish previously. As far as Australasian exports are concerned, there is the traditional preoccupation of Australia and New Zealand with the United Kingdom market, to which both countries were bound by traditions of race and culture, as well as by substantial United Kingdom investments in Australasia and the United Kingdom's policy of maintaining cheap prices for basic foodstuffs and raw materials. Other contributing factors were the low level of per capita incomes in Japan and, hence, the lack of effective demand for high protein goods such as meat and dairy products, the preference for rice rather than for other grain cereals, the dominant position of cotton-based textile industries and the political developments of the mid-twentieth century.

On the import side the preference accorded United Kingdom and Commonwealth countries in the Australasian market hindered the development of trade with Japan. In addition, Japanese imports were representative of the labour-intensive, light, consumer-goods type industries which both New Zealand

and Australia were attempting to establish with the assistance of tariffs and import licensing controls. Finally, there were two other factors which restricted a mutual expansion of trade between the three countries: the lack of any social or cultural contact in depth and the existence of only irregular and slow shipping facilities between Japan and Australasia.

Today a number of these impediments to trade have been removed or reduced in magnitude. The political reorientation which has taken place in Japan and the rapid rise in per capita incomes has brought the three economies much closer together from a social viewpoint. Rising living standards have established Japan as one of the few expanding commercial markets for primary products. At the same time, the importance of Australasian wool to the Japanese textile industry and the potential importance of Australia as a supplier of coal and minerals has led to a shipping service being established between Australasia and Japan which is at least as regular and as cheap in terms of economic distance as that between Australasia and the United Kingdom. Finally, the realisation of Australia and New Zealand that they must seek alternative markets to the United Kingdom and that they must diversify export products has seen increased efforts by both to secure markets in Japan. Despite the officially stated desire of the New Zealand Government and Producer Boards to expand trade with Japan, there is a reluctance to do so in practice because it is thought that increased trade with Japan might jeopardize New Zealand's "special position" in the United Kingdom's E.E.C. negotiations.

(b) Possible Benefits and Costs of Integration

Any move towards integration of the three economies must be seen to expand the real income of each of the individual members. That is to say, the net gains, if any, from a more efficient allocation of production and consumption between countries, from more general and effective competition between firms and industries, from a possible increase in the level of investment and from increased economies of scale, must be of benefit to all members. What is required, therefore, is an analysis of the net gains which might arise from any of the above causes and a careful investigation of the manner in which these gains are likely to be distributed between countries.

Generally speaking, the gains to be had from JANFTA as far as Australia and New Zealand are concerned would be a more rational development of their manufacturing sectors and greater access for their primary product exports to the Japanese market. For Japan, likely benefits would be a gain in the efficiency of those of its primary industries which compete with Australasian exports and access to the Australasian market for its manufactured exports on terms at least as favourable as those accorded to one another by Australia and New Zealand and no less favourable than those given the United Kingdom in the Australasian market. Adverse effects for both countries could arise from changes in the pattern of trade with non-members. Let us consider these points in greater detail.

What of the likely terms of trade effects of the establishment of a free trade area? As far as Australasian exports are concerned there is no reason why the price of wool, a commodity which is traded freely on an international market, should alter. Of the remaining exports the prices of wheat and sugar are controlled by international commodity agreements, dairy products are subject to quota restrictions on the main market in the United Kingdom and, even with free trade, the likely diversion of meat to the Japanese market would be unlikely to affect significantly the ruling international price. If anything meat prices in Japan would fall as attempts were made to expand per capita consumption of meat. This effect on the terms of trade, which would be small, would be offset by a probable rise in the prices of dairy products resulting from the elimination of a 45% tariff and an elimination of the monopoly profits made by Japanese importers. As for Japanese exports (Australasian imports) these are for the most part commodities which are in elastic supply elsewhere in the world so that little or no fall in the average price level of these goods could be expected. New Zealand, however, could improve her terms of trade slightly to the extent that she substituted lower-cost Japanese goods for higher cost Australian imports. Generally though, one would expect terms of trade effects for the area as a whole to be negligible.

Prospects for trade creation are good in that Australia and New Zealand accord high levels of protection to their manufacturing industries and Japan likewise gives a relatively high level of protection to her primary producing industries.[1]

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[1]Dairy products are subject to quota controls and carry tariffs of 45%. The exception is cheese which is not subject to quota. Other duties (in 1964) are: lamb and mutton 10%(to be reduced shortly to 5%), beef and veal 25% (also subject to quotas), dried fruits 20%, wheat 20%.

Further, domestic demand in Australasia for imports from Japan (or for the type of commodity which would be imported if tariffs were abolished) can be assumed highly elastic and this would tend to increase trade creating effects.

Trade diversion is unlikely to be large. Apart from Japan, the United Kingdom is the major trading partner of Australia and New Zealand and, since devaluation, the average difference in the costs of production in Japan and the United Kingdom of Australasian imports should not be large. At the same time, the elasticity of supply of these goods in Japan is high and the supply price is, therefore, unlikely to be increased significantly. Furthermore, the fact that it is a free trade area and not a Customs Union which is contemplated means that the average level of Australasian tariffs need not be increased and could be reduced. As far as Japan is concerned trade diversion should prove negligible in that Australasia is internationally competitive as far as primary production is concerned.

To the extent that trade diversion did occur, the United Kingdom is the country that is most likely to be affected. If the United Kingdom devaluation does make United Kingdom goods competitive with those of Japan and if the United Kingdom does not enter the E.E.C. trade diversion could be minimised providing United Kingdom goods were placed on approximately the same footing as Japanese commodities, i.e., the present preferences accorded British goods in the Australasian market were eliminated and tariffs upon manufactured imports into Australasia were reduced to 10% and below on an m.f.n. basis.

Such a move would have two effects - one favourable, one adverse to the Australasian economy. First, the terms of trade would tend to improve as United Kingdom exporters competed for sales in what had been a traditional and semi-protected market. Secondly, New Zealand and Australia could expect preferences which are currently accorded them on the United Kingdom market to be withdrawn. The effects of an elimination of preferential treatment would be serious for certain industries but the major exports such as wool, meats, butter, sugar, wheat and dried fruits require unrestricted access to the British market and guarantees about dumping rather than preferential margins. Should the United Kingdom enter the E.E.C. the removal of preferential treatment and of freedom of access to the United Kingdom market would be automatic.

Economies of Scale and The Effect of Increased Competition

Apart from the traditional argument for free trade, which is real enough, the formation of a free trade area between Australia, Japan and New Zealand may give rise to increases in real income as a result of more competitive conditions and as a result of the opportunities for production on a larger scale.

In so far as prices within national boundaries are not consistent with the minimum real costs technically attainable, increased competition could significantly increase the efficiency of production. Gains from an increase in competitive conditions are difficult to assess. Obviously, competitive conditions vary as between the three countries but it has been well-established that the Australian and New Zealand economies have a large number of sectors characterized by national monopolies or by oligopoly (13,14). The establishment of a free trade area would act as an effective anti-monopoly device and, by weakening national monopolies and oligopolistic market structures, it would enable non-price competition and price competition to become more effective. Furthermore, apart from the effect of monopolies and collusive oligopolies on competitive forces, competition in Australia and particularly New Zealand is thwarted by such things as traditional business ties and practices, the search for a peaceful existence and for stable rather than growing incomes. If a larger market were established, new firms would prove less tolerant of traditional practices and would intensify competitive conditions.

One of the important long-run effects of integration would be its influence upon the volume, pattern and value of investment. The volume of investment could be expected to increase if third parties such as the United States or United Kingdom were encouraged to increase the rate of foreign investment in the JANFTA area because of greater restrictions on access to an expanding market. The volume of investment would also be favourably affected if savings were to rise as a result of increased incomes and if the confidence of investors in the stability of the investment prospects in an enlarged market was increased. Given the already high rate of capital formation in the three countries it is probable that an increase in the flow of foreign direct investment would be the major source of gain.

The nature and pattern of investment would also alter for a number of reasons. There would over time be a change in the nature of productive equipment as mass production methods were adopted in response to the challenge of a wider market, and in the pattern of investment as output of high-cost firms was reduced and low-cost firms increased. Changes in the direction and channels of investment might also be expected, providing there were no controls on the free flow of capital within the free trade area. The major precondition for these changes in the nature and volume of investment is that investors should have confidence in the continued free movement of products and of capital within the Area. Otherwise, the required changes in the structure and volume of production would not be forthcoming.

Integration would give rise to a number of economies of scale that should be of importance to Australian and New Zealand manufacturers who for a number of reasons have not exploited adequately the gains to be had from mass production in long runs of a standardized product. An example is the New Zealand electronics industry. The entire market is not quite large enough to cater for one optimum-size plant producing radios, yet in 1965 there were some twenty-six firms engaged in the production of radio sets or components. D.O. Sewel has shown that the cost of production of a radio in a New Zealand subsidiary is at least 100% higher than the cost of production of a similar radio in the European based parent concern (10,117). This example is typical of many industries in Australia and New Zealand where, even though the market may be too small for one optimum size industry, several sub-optimal firms are to be found in the same industry. In part this is due to a deliberate attempt of the authorities to foster competition by granting import licenses to two or more firms; in part it is due to the general lack of competition in the New Zealand market.

Apart from the effects of trade diversion the other main objections to the establishment of a free trade area between Japan, Australia and New Zealand would be that wage levels in Australia and New Zealand might be threatened, that certain industries would suffer dislocation and structural unemployment and that full employment policies would be jeopardized because governments would need to resort to deflationary policies to control balance of payments problems.

The objectons contain more emotive than logical content. Wage levels are geared to productivity and, in any case, absolute wage levels are not a determinant of the gains to trade of any one country. While it is true that the distribution of incomes could be affected by free trade, losses due to redistribution could be offset by appropriate social policies if they were not eliminated by rising per capita incomes. Inevitably, if there are to be any gains, some industries could be expected to contract as a result of free trade. The problem here is to modify the transitional effects of these structural changes by policies which are designed to retrain and employ displaced labour and even to compensate industries which are forced to close down. Finally, what of the threat to unemployment posed by the need to control the balance of payments with deflationary measures. In the present world of fixed exchange rates such deflationary measures are already required if the balance of payments problem is a structural one. (New Zealand has recently discovered the limitations of import licensing controls as a long-term balance of payments remedy). If anything, because of the greater interdependence of countries in a free trade area, member countries should be more prepared to provide short-term assistance to one another when short-term balance of payments difficulties arise and more willing to encourage the alteration of exchange rates where disequilibrium is of a structural nature rather than to suffer the consequences of deflation or the imposition of import controls by a member country.

(c) The Need for Quantitative Analysis

While it is instructive to point out the various possible costs and benefits, such qualitative analysis provides no adequate substitute for a detailed calculation of the gains or losses which are likely to arise from economic integration. Unfortunately, the latter is a forbidding task and I am unaware of any instances of its having been attempted satisfactorily. Quite apart from the benefits or losses which arise from increased competition and from an enlarged market, the more humble estimate of net gain from trade creation, trade diversion and changes in the terms of trade is a difficult one. This latter calculation requires a detailed knowledge of effective rates of protection and of demand and supply conditions in not only the member countries of the area to be integrated but also their trading partners. As far as JANFTA is concerned such information is not available and could not be obtained without a vast amount of work. Moreover, as far as New Zealand is concerned the problem is compounded further by the recent devaluation, the effects of which have yet to work themselves out, and by the intensified use of import licensing controls which makes the estimate of effective rates of protection such a difficult task.

For the above reasons I feel that estimates made by Professor Kojima are of doubtful value. He has attempted to measure the likely extent of the trade creation and trade diversion which would follow the establishment of a free trade area between the United States, Japan, Canada, Australia and New Zealand (7). To assist him in this calculation he has made use of nominal tariff rates and of import demand elasticities calculated with regard to the United States by R. J. Ball and K. Mavwah (9). These elasticities are calculated for the U.S.A. for five broad categories of commodities. The degree of commodity disaggregation, however, is quite insufficient to make use of these coefficients of elasticity for all 'advanced' countries. Moreover, Professor Kojima has assumed that export prices will remain constant despite the very considerable trade imbalances indicated by his results (7, 24) and despite the implications which a constant export price level must have for other elasticity coefficients.

An attempt to calculate the net gain or loss arising from a full free trade relationship between Japan, Australia and New Zealand is made more difficult in that trade in the given situation of today is less than it would be because of the historical attachment of Australia and New Zealand to the United Kingdom market. For instance; there is the obvious reluctance noted above of New Zealand to push trade with Japan. Once these historical attachments were weakened the increase in trade might be far greater than that indicated by the removal of existing tariff structures and by the most assiduously calculated elasticity coefficients.

Because of the extensive practical difficulties in estimating the gains and losses which would arise from JANFTA it is most unlikely that any one of the proposed members would accept a proposal for integration on other than a sectoral basis. That is to say, quite apart from the opposition of producer-oriented pressure groups and the inevitable fears of unemployment and of structural change, no country would proceed with integration upon a broad front while it was uncertain about increasing the average level of its per capita incomes. Because of this uncertainty there is much appeal in proceeding with integration on a sectoral or industry basis. Such a development is already taking place between Australia and New Zealand as a result of NAFTA (The New Zealand - Australia Free Trade Area Agreement). In the next section NAFTA is appraised with a view to Japan entering the Agreement.

IV The New Zealand-Australia Free Trade Area Agreement

The New Zealand-Australia Free Trade Area Agreement (NAFTA) was signed on the 31st of August 1965 and its stated objectives are to "Further the development of the Area (New Zealand and Australia) and the use of the resources of the Area by promoting a sustained and mutually beneficial expansion of trade" to be conducted "under conditions of fair competition" which would contribute to "the harmonious development and expansion of world trade".

To date, the stated objectives of NAFTA have proved to be no more than pious hopes because of a number of safeguards built into the Agreement. For instance, Article Four proceeds to weaken the Agreement by stipulating that the general reduction and elimination of duties called for need apply only to those commodities listed in Schedule A of the Agreement although Article Three provides for annual reviews when, among other things, there is to be a progressive listing within the Schedule of "all goods which enter or might enter into the trade of either Member State".

There is nothing automatic, however, about the inclusion of these commodities upon the list and specifically excepted are those "goods the inclusion of which would be seriously detrimental to an industry in ... either Member State, or would be contrary to the national interest of either Member State, or would be inconsistent with the objectives of any commodity arrangement to which both Member States are parties".

Once commodities have been included in the Schedule to the Agreement the general requirement is that they will immediately become free of duty if subject to a prior tariff of less than 5%, that they will become free of duty intwo years if subject to prior duties of 5 - 10%, that if subject to prior duties greater than 10% they will become free of duty over eight years.

As if the above safeguards were not sufficient others were added to ensure that the structure of New Zealand's industrial development could not be affected. Apart from what are normal provisions permitting action against dumped and subsidised imports and escape clauses permitting the withdrawal of concessions where serious injury is likely to domestic producers the Member State is also able for the purposes of encouraging new enterprises to suspend its obligations on items listed in the Schedule and to levy duties on such items at a reducing rate for a period of up to twelve years. In exceptional circumstances it can withdraw items indefinitely from the Schedule. Finally, it is stipulated that Import Licensing Controls may be maintained or reimposed even on scheduled goods providing the imposition of such controls is consistent with the member's international obligations and are for balance of payments reasons only.

The extent to which NAFTA might lead to a substantial freeing of trade between the member countries depends upon the number and significance of the commodities listed in the Schedule, upon how quickly this list is extended and upon the willingness of both countries to refrain from invoking the safeguard clauses. To date, by all three criteria, the Agreement must be judged a failure.

It was the proud claim of both Governments that the original Schedule to the Agreement listed items which between 1962-63 and 1963-64 comprised some 60% of total trade between the two countries. Some 53% in value terms of New Zealand imports from Australia were included and some 86% of the goods which Australia imported from New Zealand. This method of appraising the liberal nature of the Agreement, however, conveniently overlooked that most of these items were already duty free and that many more commodities would have been traded in the past had it not been for import licensing controls and the existence of high tariff barriers. This point is made obvious by Table X which shows that despite a slight increase in trade between the two countries since the signing of the Agreement, trade in Schedule A commodities has suffered a proportionate and absolute decline. It is clearly those items not listed in the Schedule that offer the major trading benefits.

The procedure for including new commodities upon the

Schedule is fortunately left to the initiative of the two Governments and not to that of private manufacturers or producers. After the two Governments have agreed upon a list of goods which might be considered for addition, this list is published and all interested individuals and bodies are invited to submit their views. Where manufacturers and producers hold that their interests are jeopardized an enquiry is held by an appropriate authority in each country.

There can be little doubt, however, that unless each Government is inclined to give more substance to the Agreement the above machinery for including extra items on the Schedule will not be overtaxed. On one side of the Tasman the New Zealand Deputy Prime Minister and main architect of NAFTA has stated that "although the aim is the eventual establishment of a comprehensive free trade area this will not be achieved in a way that will be seriously detrimental to an industry in either country" (2, 34). On the other side of the Tasman, the then Australian Deputy Prime Minister made it abundantly evident that any items that Australia might offer to include in the Schedule will be such as to avoid reducing the level of protection given to Australian manufacturing industries (3, 23). Table X indicates the success both Governments have had in achieving these aims.

TABLE X

NEW ZEALAND'S TRADE WITH AUSTRALIA

($N.Z. Million)

1. Total Trade:

	Exports to Australia. (f.o.b.)	Imports from Australia. (c.d.v.)
1964	32.4	129.8
1965	31.0	130.8
1966	32.0	139.6

TABLE X Cont'd

2. Schedule A Trade:

	1963-4	1964-5	1965-6
(a) Value of Schedule A between Australia and New Zealand	99.68	85.20	86.08
(b) As percentage of total trade betwen Australia and New Zealand	58.5%	51.6%	49.9%

Given the serious intentions of its members, NAFTA does provide a framework for a more extensive freeing of trade between the two countries but it is still debatable whether or not the Australasian market is a large enough one to allow for a range of economically viable manufacturing industries. There is little which can be said about this problem at a general level but the line of argument developed above suggests that the Australasian area comprises too small a market for successful industrial development. Support for this point of view is given by the general impression of Professor Austin Robinson who in editing the Symposium on "The Economic Consequences of the Size of Nations" concluded that "most of the major industrial economies of scale could be achieved by a relatively high income nation of 50 millions; but nations of 10-15 millions were probably too small to get all the technical economies available ..." He continued to say that "There are probably significant economies in integrating nations of the size of 10 - 15 millions".

Clearly, while so few commodities of importance to producer interests are included in Schedule A, the opportunity exists for renegotiating the Agreement with Japan (JANFTA) and for proceeding with integration upon a sectoral basis. We turn next to consider argument for and against integration by sector or industry rather than on a broad front.

V Sectoral Integration

The major argument in favour of proceeding with economic integration upon a sectoral basis is that politically it is more feasible because Governments are more likely to make limited decisions, the results of which are more clearly forseeable and, therefore, acceptable to an electorate. Moreover, success of integration plans in one industry or group of industries may provide the stimulus and encouragement for integration to be proceeded with upon a larger scale. There is much to be said for this line of argument and one can point to the case of the European Iron and Steel Community. When the ECSC was first contemplated, an attempt to integrate its participating members across a broad front would have been doomed to failure. A more limited measure of integration gained approval and would seem to have contributed later to the formation of the E.E.C.

As argued above, this last point is relevant to any projected integration of the Australian, New Zealand and Japanese economies. At this juncture any macro-economic calculation of the possible costs and benefits of the complete removal of trade barriers would need be treated with caution. It is not even enough to know that the area as a whole is likely to gain unless it can be shown that each of the individual countries stands to benefit. The complete removal of barriers to trade would involve substantial changes in the distribution of incomes if not in the average level of per capita incomes and because no water-tight method exists of guaranteeing any individual country compensation in the event of real income loss, governments would be naturally reluctant to agree to a proposal for full integration. Integration on a sectoral basis would allow Governments to bargain for such compensation. This is an argument, therefore, for integrating more than one but not all sectors at a time. As far as existing industries are concerned, a development which was likely to prove harmful to a politically important production group in one country could be offset by the integration of another industry in which integration effects would be favourable to producers, In the case of Australia, New Zealand and Japan this need not only involve integrating different industries, such as the automobile industry and the meat industry, but could also involve specialisation occurring within an industry as has happened in the E.E.C.

For instance, in Australia in 1962-63 fourteen firms were engaged in the manufacture or assembly of motor vehicles. Only six of these firms were engaged in any substantial manufacturing themselves although many small firms specialised in producing components. A wide range of cars, station-wagons and other vehicles were produced in a highly protected market. Most favoured nation duty rates on complete motor cars were 35% and on components most favoured nation rates varied between 35% and 52½%. Despite these high rates of protection, and despite the number of firms producing a wide variety of products in what is a relatively small market (in 1962-63 some 345,000 new vehicles were registered in Australia) the industry has developed some export markets. Competition with Japan would inevitably involve mergers and concentration upon producing a more limited range of vehicles and components but it is difficult to see the motor vehicle industry in Australia being eliminated by the removal of protection. It is possible that reduced unit costs resulting from competition and economies of scale could result eventually in the industry expanding.

In automobile production, 600,000 is alleged to be the optimal output per plant in the U.S.A. Costs are moderately higher at 150,000 and considerably higher at 60,000 units (above the Australian average output) (16, 245-247).

Another advantage of integration by industries is that trade diversion and adverse terms of trade effects could be minimized. For instance, the competitive status of certain United Kingdom industries could be preserved in the Australasian market.

Finally, apart from a more rational development of existing industries a sectoral approach to integration would also enable a more logical development of industries which have yet to be started.

There are a number of theoretical objections which have been made about integration proceeding on a sectoral or industry basis. One of these is that integration in one sector alone, e.g., in the case of Australia, Japan and New Zealand the automobile industry, would result in losses as far as some of the partners were concerned. This type of argument assumes, first, that the country whose industry contracts actually loses real income despite lower cost products being available to consumers; and, secondly, that a general integration of the economies concerned would benefit all members. Neither of these contentions is necessarily correct and it is this uncertainty which attaches to the complete removal of trade barriers which is the major practical problem. As noted above, if more than one industry at a time were integrated, compensating adjustments could be made to see that all member countries benefitted.

A more general criticism is that under the sectoral approach every step in integration results in a new and temporary equilibrium of prices, costs and resource allocation. As a result, production decisions will be made on the basis of prices that are relevant only at a particular point in the integration process and the resulting resource shifts may be seen later to have been wasteful. Presumably, however, the establishment of new temporary positions of equilibrium will occur also where integration involves all industries but proceeds in a series of discrete steps. In this case, therefore, one cannot argue that there will be no wasteful shift of resources until all adjustments have been made.

A further and related objection is that the establishment of temporary equilibria (as a result of the sectoral approach) may require deflationary or exchange rate adjustment measures aimed at relieving balance of payments pressures. These, it is argued, will tend either to check the growth process in the deficit country or, as a result of temporary adjustments in exchange rates, lead to unnecessary changes in the international division of labour. Once again this objection applies equally to the situation in which tariffs on all items are reduced by a series of discrete steps. It might be thought that a criteria for integrating only a limited number of industries is that the balance of payments effects of the integration process could be minimised. This is an undesirable criteria, however, because it is the real income effects of integration which are important and maximum real income effects may require exchange rate alterations. What is required is machinery to allow a deficit country to make the necessary adjustments without the need to apply severe deflationary measures.

Another criticism of integration by sectors is that it is less likely to lead to co-ordination in monetary, fiscal and other policies which are required if the industries in the integrated sectors are to be truly competitive. This criticism is valid in that countries would be less likely to harmonise policies where they did not intend to integrate all sectors. One can point, however, to the record of the E.I.S.C. which shows that some co-ordination was successfully achieved in the field of transport, tax and commercial policy. (8, 288-416).

What of the objection that integration on a sectoral basis will lead to a conflict of producer and user interests which will normally resolve itself in favour of the former? Producers with a vested interest in the industry selected for integration are bound to be vocal but this emphasizes the need to select more than one industry at a time so that the clamour of one group can be offset by the favourable lobbying of another.

Finally, there is the argument that G.A.T.T. regulations prohibit partial economic integration. What is important is the ultimate aim of the member countries, and to the extent that they could show that trade diversion would be minimised and that integration on a sectoral basis would be a continuing process, it is unlikely that G.A.T.T. would object. It has not, for instance, in the past objected to such partial integration on the part of the E.I.S.C. or N.A.F.T.A.

Finally, there are a few random comments which I should like to make.

If integration on a sectoral basis is to prove successful, it would be important for detailed industry studies to be carried out which would provide data on competitive conditions and the structure of the industries concerned, on underlying demand and supply conditions and upon effective rates of protection. This information would be essential if a prior estimate of the effect of integrating certain industries was to be made. It would also be required in order to defeat the lobbying of vested interests and to allay the fears of the general population. To facilitate these industry investigations some Joint Economic Council might be established, the members of which would be trained analysts provided by the three countries.

While JANFTA could be of considerable benefit to the Australasian economies, the small increase in the size of the market as far as Japan is concerned would make the benefits relatively less important. Such a free trade area arrangement, however, could provide the framework for including other countries at a later date such as Canada, the United States and some of the less developed economies of the Pacific Basin.

JANFTA should in a number of ways facilitate the rendering of assistance to under-developed countries. A joint foreign aid programme could be established; preferential tariff treatment with the free trade area could be given to some of the underdeveloped areas of the Pacific Basin; and joint investment projects could be undertaken by the three advanced economies which would establish processing industries in underdeveloped countries that would cater for local tastes and reduce the supply price of the finished product by employing low-cost local labour.

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TABLE I

EXPORTS OF AUSTRALIAN AND NEW ZEALAND PRODUCE ACCORDING TO INDUSTRIAL ORIGIN
(As % of Total Exports)

	Australia		New Zealand	
	1953-54	1964-65	1953-54	1964-65
Industrial Group				
Agricultural	19	24	2	2
Pastoral	60	45	67	70
Dairy	6	5	28	23
Mining	7	10	-	-
Forestry and fisheries	1	1	1	3
Total primary	93	85	98	98
Manufacturing	6	13	1	2
Unclassified	1	2	1	-
Total	100	100	100	100

Source: Official Yearbooks of the Commonwealth of Australia; New Zealand Official Yearbooks.

TABLE II

IMPORTS AS A % OF G.N.P. IN AUSTRALIA AND NEW ZEALAND

Year	Aust.	N.Z.	Year	Aust.	N.Z.
1953-54	14.7	21.6	1956-60	13.2	18.6
1954-55	16.9	25.9	1960-61	14.1	22.2
1955-56	15.2	24.6	1961-62	11.5	18.6
1956-57	12.1	23.6	1962-63	12.8	17.9
1957-58	13.2	24.6	1963-64	12.6	19.9
1958-59	12.5	19.1	1964-65	14.1	18.9

Source: As for Table I

TABLE III

IMPORTS OF AUSTRALIA AND NEW ZEALAND ACCORDING TO INDUSTRIAL USE (1964-65)

	% total imports	
	Australia	New Zealand
Producers materials for use in manufacturing	51	49
Capital equipment	27	25
Fuel and lubricants	2	7
Other	5	5
Consumer goods	15	12

Sources: As for Table I

TABLE IV

INTENSITY OF TRADE FOR 1960-62 (AVERAGE) AND FOR 1965++

Exports to	Japan	Australia	New Zealand
Exports from			
Japan	-	170 (185)	95 (124)
Australia	418 (347)	- -	1053 (1108)
New Zealand	97 (109)	223 (238)	-

++ 1965 figures in parenthesis

Source: United Nations Statistical Yearbook, 1966.

TABLE VI

EXPORTS AND IMPORTS OF AUSTRALIA, JAPAN AND NEW ZEALAND AS % TOTAL EXPORTS AND IMPORTS

Exports to / Exports of	Australia	Japan	N.Z.	Imports from / Exports of	Australia	Japan	N.Z.
Australia	-	16.6	6.3	Australia	-	9.7	1.5
Japan	3.8	-	0.7	Japan	6.8	-	0.8
New Zealand	4.7	5.1	-	New Zealand	18.8	6.3	-

Source: As for Table I

TABLE VII

PRINCIPAL IMPORTS OF NEW ZEALAND (JUNE YEAR, 1965)

	N.Z.$(000) Total	Value of imports from Australia	Japan
Fertilizers	12,682	-	-
Motor spirit, etc.	19,334	6,420	-
Organic and inorganic chemicals	17,075	3,274	784
Pharmaceuticals	12,772	3,735	-
Plastics	15,487	2,797	-
Textiles	50,428	3,494	8,901
Iron and steel	50,118	23,535	10,966
Aluminium and copper	16,290	3,726	-
Motor vehicles	71,409	15,744	341
Electrical machinery and equipment	40,114	2,697	295
Total (principal imports)	306,339	65,422	21,287
Others	356,328	62,546	15,397
Total	662,667	127,968	36,684

Source: New Zealand Yearbook, 1967.

TABLE VIII

PRINCIPAL EXPORTS OF NEW ZEALAND
(JUNE YEAR, 1965)

	N.Z.$(000) Total	Value of exports to Australia	Japan
Wool	208,640	1,896	13,923
Beef and veal	57,409	-	345
Mutton and lamb	134,972	-	5,981
Other meats	20,394	636	47
Butter	119,647	-	-
Cheese	40,681	168	557
Milk (dried)	18,890	-	598
Other animal products	65,947	387	3,858
Wood pulp and newsprint	16,711	16,322	184
Total (principal exports)	683,291	19,409	25,493
Others	58,881	15,159	7,807
Total	742,172	34,568	33,300

Source: New Zealand Yearbook, 1967.

TABLE IX

PRINCIPAL IMPORTS OF AUSTRALIA (1964-65)

Commodity	A$(000) f.o.b.	Value of imports from Japan.
Aircraft and parts	85,993	-
Apparel	25,367	3,024
Chemicals, drugs, fertilizers	184,720	7,744
Electrical machinery and appliances	139,277	
Iron and steel	102,802)	
	)	110,212
Machines and machinery	506,769)	
Motor vehicles	252,896	
Oils	210,159	1,684
Paper	103,314	6,626
Piece goods	135,135	72,310
Plastic materials	62,407	-
Rubber	59,983	-
Total (principal imports)	1,869,522	201,600
All other	1,035,181	56,974
Total	2,904,703	258,574

Source: Australian Yearbook, 1966.

TABLE X

PRINCIPAL EXPORTS OF AUSTRALIA

(1964-65)

Commodity	A$(000) f.o.b.	Value of exports to Japan
Butter	62,165	36
Cheese	14,197	1,118
Chemicals	30,497	
Coal	51,120	48,082
Fruit (fresh, canned and dried)	82,227	
Grains and cereals	391,859	36,672
Hides and skins	79,534	
Iron and steel	61,687	18,298
Lead (pig and bullson)	60,432	
Machines and machinery	42,373	
Meats	276,443	10,272
Ores and concentrates	80,954	16,942
Sugar	112,685	35,142
Wool	805,850	242,658
Total	2,581,913	440,740

Source: Australian Yearbook, 1966.

Session II

COMMENT ON L.V. CASTLE'S PAPER

By Gustav Ranis

In addition to the usual disclaimer, that is, that I am not knowledgeable on the New Zealand economy, I have to admit to not being a trade expert. It is for the reason that I especially welcomed, from a purely selfish point of view, the unusual clarity and comprehensiveness of Professor Castle's paper; but I would venture to guess that others also benefitted from it.

The scene conveyed by the author depicts the U. K. and New Zealand in a devoted mother-child relationship, with the mother beginning to show signs of straying, and the child beginning to worry and exhibit withdrawal symptoms--but not as yet willing to leave home and face the world.

Nevertheless, as Professor Castle himself indicates, the real world has forced a change on New Zealand which was, in fact, quite dramatic, especially when contrasted with changes over the previous 50 years. Exports to the Pacific area, for example, are now 33% of the total as compared to 15% in 1956. Professor Castle takes the New Zealand government to task for not having adopted specific policies to this end; but if the economy, in fact, was able to respond to changes in market forces the government must, at a minimum, have been accommodating, and, in fact, we know that it was at least that. It responded to changing income growth patterns in Japan and Asia vis-á-vis the U. K. in terms of the trade agreements entered. Perhaps Professor Castle's objection is more to New Zealand's mentality rather than her actions.

With respect to the key commodities of lamb, butter and cheese, which comprise more than 40% of New Zealand's exports, Castle especially deplores the continued almost total dependence on the U. K. But is it not too simple to say that New Zealand refused to turn to the Pacific just because she feared the possible hurt to her industries from having to grant reciprocal access? One would need to know more about the lamb market, for instance to know whether New Zealand is a price maker or price taker, what her competitive situation is, etc., before one could weigh the benefit of access against the costs of reciprocity plus the costs and benefits of the special bulk purchase type of arrangement while it lasted. One can agree on the dangers of indefinite preferences in drugging a system into inaction but the validity of the case can only be established if the options or opportunities foregone can be cited clearly.

I have one other related caveat to put forward--and that is that I would warn Professor Castle against undue reliance on the FAO forecasts of demand and production on a global basis, forecasts which seem to have influenced the tentative conclusion that the dairy industry may well go by the wayside while meat continues strong. These conclusions may well be right but I would not like to base them on projections which are devoid of any price assumptions.

I cannot resist commenting on one other point--though it is not central to Professor Castle's argument, and that is that on p.104 the paper states that "food aid is not directly connected with economic development and may indeed damage the prospects of increasing domestic agricultural productivity". With respect to the first part of that statement, I can agree that free and unfettered aid may be better from the recipient's point of view but that is not usually the relevant choice. Aid tied to a particular donor may only be worth 90 ¢ of the dollar (due to non-competitive prices and incomplete "flexibility" of foreign exchange resources); aid tied to both particular commodity and a particular donor may only be worth 80 ¢ of the dollar; but in either case these represent additional resources permiting the recipient to do additional things, including grow faster. With respect to the "disincentive" issue raised in the second part of the quoted statement, there certainly can be a problem here if agricultural resources are dumped indiscriminately in a market which is trying to increase the contribution of domestic production. However, as the experience of Pakistan since 1961 well illustrates, P. L. 480 assistance infused carefully into the system in the form of a buffer stock to moderate agricultural price fluctuations and permit the free price trend to decline slowly with time is perfectly consistent with increasing agricultural productivity as the effort is made domestically to help close the gap. The whole emphasis agricultural productivity increases, where obtainable on efficient terms, in the most recent United States P.L.480 legislation is based on the assumption that such careful infusion of agricultural commodities into the less developed world is possible as we buy time to get much of the problem solved domestically.

Finally, I cannot resist commenting on how much I was struck by the likeness of New Zealand's behavior to the typical less developed economy syndrome; import licensing, import substitution, strong (one might say somewhat premature) welfare programme, budget deficits, inflation and low growth rates. I realize that currently there is some stirring around in terms of potentially profound changes in this picture; but in the meanwhile I wonder how New Zealand can reasonably consider the relatively big step involved in a Pacific Free Trade Area where so little has been done and dared in connection with the Australia-New Zealand free trade zone. As long as activation of that relatively small step is subject to the constraint that "no New Zealand industry be damaged" we seem to be a long way from realizing any of the bigger steps being discussed; that is, unless it is politically more palatable to be "hurt" more by some one further afield than Australia.

COMMENT ON I.A. McDOUGALL'S PAPER

By Takuji Shimano

Prof. McDougall's paper examines the impact of a free trade area between Australia, New Zealand and Japan, (JANFTA) on the pattern and possible volume of intra area trade, giving consideration to the major objectives of economic policy in Australia and New Zealand.

The first section of his paper is devoted to a survey of major policy objectives (full employment of a growing workforce, raising per capita income, an equal distribution of incomes, and stability of incomes brought about by each country regulating the market mechanism internally and endeavouring to become less dependent upon international trade). It may be common for nearly all countries to point out the first three policy objectives, but the last objectives should be examined more closely, I think. Why should reduced dependence upon international trade be one of major policy objectives? Why could not the expansion of gains from international trade be regarded as one of the main policy objectives for achieving economic growth? It seems to me curious at first sight, because Prof. McDougall has in his paper(pp.111 and 113) clearly mentioned that "neither country has proved markedly successful in reducing its dependence upon international trade".

Besides the high dependence of Australia and New Zealand upon a narrow range of primary product exports, the prevalent tendency towards agricultural protectionism in industrial nations makes structural change difficult for both countries.

One solution may be a policy of import substitution which brings about a favourable effect on terms of trade. But according to the interpretation of Prof. McDougall, import ratios have failed to fall significantly (p.111). Major causes have been the spill-over of unsatisfied import demand of a number of import-competing industries which has generated inflationary pressures and made expansion difficult for efficient import-competing industries. At the same time, "consumers have reacted to rising domestic price levels by switching their demand back to relatively cheaper imports."

This process and Table III of Prof. McDougall's paper teach us clearly that the objective to reduce dependence on international trade was not only unsuccessful, but also incompatible with the policy objective of full employment both from a short-run and long-run standpoint. Thus, I agree with Prof. McDougall's alternative policies in the first section (p.113-114) which "would allow manufacturing industry to develop in accordance with each country's comparative advantage." This policy guarantees that manufacturing development in Australia and New Zealand will be competitive and increase its efficiency and, lastly, would lead to the establishment of export industries through technological improvement.

Section II investigates some characteristics of JANFTA from the viewpoint of market size, trade relations, and levels of protection in the member countries.

Section III provides a qualitative analysis with respect to the possible benefits and costs of integration through the achievement of economics of scale and the effects of increased competition. According to Prof. McDougall's tentative conclusion, one would expect terms of trade effects for the area as a whole to be negligible. As far as the trade creation effect is concerned, domestic demand in Australia for imports from Japan can be assumed highly elastic and this would tend to increase trade creation effects. Finally trade diversion effects are unlikely to be large, given high supply elasticities of Japanese goods and relatively stable supply prices.

On the other side, gains from increased competition through the establishment of a free trade area are difficult to assess. But to summarize the issues: a) The establishment of a free trade area would enable non-price competition and price competition to become more effective. b) If larger markets were established, new firms would prove less tolerant of traditional practices and would intensify competitive conditions. c) The important long-run effect of integration would be its influence upon the volume, pattern and value of investment. d) Integration would give rise to many economies of scale which should be important to partner countries.

It seems to me that quantitative analysis which provides a detailed estimation of the gains or losses likely to arise from economic integration and the direction of possible changes in trade relationship should be systematically attempted besides the above mentioned qualitative analysis. But it is even very difficult to estimate net gains from trade creation, trade diversion and changes in the terms of trade for each country. As

Prof. McDougall has also correctly observed, this quantitative estimation requires a comprehensive knowledge of effective rates of protection, price data and of demand and supply conditions in not only the member countries of the area, but also their trading partners throughout the world.

As far as the terms of trade effect is concerned, I am tempted to propose here an empirical method with a simple theoretical background: (See T. Shimano, On the Measurement of the Import- and Export-biased Productivity Change in Japanese Economy mimeographed , 1967). Not only the composition of changes in exports but also the expansion in volume terms for one country are due to external and internal factors. With respect to external factors, it is of importance to notice the rapid expansion effect of the intra-areal trade in manufactures in highly advance countries, while with respect to internal factors technical change, through increasing investment in rationalisation and modernisation, contributed to enhance the adaptability of exportables to changing demand conditions in other countries. In other words, structural changes on the supply side play quite a significant role in the growth performance of exports. It is here perhaps worth noting in passing, that the export performance of industrial sectors depends both on private initiatives and the impact of policy. My empirical method for calculating terms of trade effect derives from the theory of Hicks and Johnson. Their theoretical interpretation includes two problems which are also of interest in empirical research; 1) Technological or productivity change that does not take place uniformly in all industries and has a differential effect on the balance of trade. 2) Their model hints at the direction of structural changes in world economy through transition of trade centres in the process of productivity changes.

I shall limit myself to three comments on Prof. McDougall's paper. Firstly, if one takes Prof. McDougall's investigation of trade effects as being approximately correct and if liberalization had no further consequences for the economy, one might well conclude that all of the efforts required to bring about a free trade area within three countries are desirable and acceptable for each country. However, because of the extensive practical difficulties, Prof. McDougall concludes that "it is most unlikely that anyone of the proposed members would accept a proposal for integration on other than a sectoral basis". I can understand that there are many inherent difficulties of establishing a free trade area and the another obstacles which are already built in institutional regulations in planning JANFTA. But it is not convincing and it seems to me that it is logically inconsistent to point out the impossibility or ineffectiveness of an integration directly after referring to the difficulties of quantitative investigation and the implausibility of Prof. Kojima's empirical research. I was puzzled by this suddenly changed conclusion.

Secondly, Prof. McDougall has given his attention to the effects of protection upon the organization and behavior of Australian industries and the effects of her protection in international specialisation. Since Australia and New Zealand have primary-product biased economies, removal of protection might bring complete specialisation in certain lines of activity with substantial relative shifts between expanding and contracting industries. His analysis depends on a chain of reasoning which can briefly be summarized as follows: The existence of tariffs in Australia and New Zealand permits high domestic prices which in turn allow inefficiency to be maintained; this inefficiency results primarily from the small scale of both domestic markets and, therefore, a lowering of tariffs would be desirable because of the possibility of reducing inefficiency and domestic prices. The link in his line of reasoning is the attributing of high prices or inflationary pressures in both countries to the degree of inefficiency present in industrial sectors. As Prof. McDougall pointed out, high prices are found in both efficient and inefficient industries, the only difference being that in the former either excess profits or high selling costs are also present. Therefore, it seems to me that price setting in both countries requires more explanation and probably would turn on the question of the number of the competitors and the quality of competition within industries.

Let me now turn to the issue of tariffs. Tariffs are recognized as a permissive condition for inefficiency and they are said to constitute the main barrier to integration in this area. But I think that tariffs are not a sufficient condition for integration. I would like to ask whether tariffs are even a necessary condition for it.

Finally, much more important is Prof. McDougall's proposal for sectoral integration. The study of the workability of sectoral integration is of considerable importance. Sectoral integration may make it feasible to realize much greater integration through limited governmental decisions, and act as stimulus for integration to be pressed on a larger scale.

This proposal is a very practical and constructive means for promoting JANFTA in near future. It has much merit and deserves close attention.

DISCUSSION CN CASTLE'S AND McDUGALL'S PAPER

In reply Prof. Castle agreed that no detailed cost benefit study had been undertaken of the effect of British preferential arrangements on New Zealand's principal agricultural exports or of the gains through switching to Pacific country markets. But he maintained that the facts and prospects he had adduced seemed to support his general conclusions. With respect to the nature of the market for New Zealand's principal exports, he suggested that she was a price-taker in the case of butter and lamb, and a price-maker in the case of cheese.

Prof. Castle emphasized the difficulty of making quantitative estimates of the effect of liberalization on New Zealand's exports to Japanese, United States, and Canadian markets because of the prevalence of quota restrictions. This also applied in the Australian case. He agreed that, for this and other reasons stressed by Prof. Ranis, it would be unwise to base agricultural policy on FAO-type projections.

As to the prospects for the adoption of more ambitious policies to diversify the market and commodity structure of New Zealand's trade in view of her timidity about the Australia - New Zealand Free Trade Agreement, Prof. Castle suggested that there has been a significant change in official attitudes since New Zealand was forced to follow British devaluation. These changes have taken place in the last few months and they may permit a more adventurous approach to international economic policy.

Prof. McDougall took up two points which Prof. Shimano raised. He reiterated his skepticism about the value of quantitative estimates of trade liberalization which were based upon very simple assumptions. He stressed that the result of tariff protection in New Zealand was to encourage the establishment of numerous extremely high-cost inefficient industries.

The discussion which followed ranged over many issues, the most important of which were: the relative merits of the sectoral versus the wider free trade area approach to trade liberalization; the practical meaning of the sectoral approach to freer trade; the nature and significance of the industrialization objective in New Zealand's economic policy; and the feasibility of a JANFTA arrangement.

Some cautioned against the possibility that the sectoral approach might lead to greater degrees of protection rather than freer trade. First, the effect on effective rates of protection must be taken into account. Second, the scope for trade diversion within sectoral free trade arrangements might be very great. Both points were illustrated by reference to the New Zealand-Australia Free Trade Agreement which incorporates an element of the sectoral approach to "freer" trade, although these illustrations were qualified to the extent that this arrangement is still in an early stage of development.

Several participants sought a more precise definition of the term "sector". Does it mean some broad economic sector, such as agriculture or engineering, or does it refer to a much narrower range of commodities? These questions assumed importance in a discussion of the political feasibility of the sectoral approach. For example, it was suggested that it would be impossible for Australian negotiators to give concessions on imports of manufactured goods without the promise of reciprocal concessions on agricultural exports, despite the economic usefulness of unilateral tariff concessions. Others sought an explanation of the economic rationale of sectoral integration, more narrowly defined.

The different positions of the New Zealand and Australian economies were also brought out in discussion. Size, the degree of industrialization, rates of growth in industrial productivity, and the degree of industrial competitiveness clearly distinguished the two economies. The iron and steel industry and motor vehicle industries were cited as two of many Australian 'infant industries' which had unsuccessfully matured. One participant suggested that the case for continued infant industry protection was much stronger in the case of New Zealand. Some felt that it would be difficult for New Zealand to contemplate a substantial freeing of trade, even among Australia, Japan, and New Zealand, without taking account of the damaging effects on industrialisation objective. It was suggested that market forces alone might not lead to industrial rationalisation to New Zealand's advantage.

There were some differences of opinion about the economic justification for the industrialisation objective. One participant suggested that its justification might be found in the lack of fact or substitutability in the primary export sector and the need to maintain full employment through industrialisation, rather than through conventional commercial and other policy adjustments. Others stressed the importance of the terms of trade argument for protection in a New Zealand-type economy and others the importance of the population variable in relation to protection of the industrial sector in New Zealand, Australia, and Canada.

Finally, many comments related specifically to the JANFTA proposal. Participants drew attention to the lopsided nature of the proposed free trade area. Only a very small proportion of potential partner-country trade is presently intra-areal. The main benefits of closer economic co-operation among the three countries appeared to derive from increased bargaining strength and stature vis-á-vis the United States and Europe, the prospects for co-operation in aid-giving to Asian countries, and its potential as a basis for more general moves towards freer trade.

Chapter 5 JAPAN'S INTEREST IN THE PACIFIC TRADE EXPANSION[1]

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I Introduction

International trade policies are volatile and searching for fresh directions in the Post-Kennedy Round situation. A restructuring of Atlantic trade can be anticipated. In the Pacific region, there is need to develop measures for expanding trade among advanced countries (the United States of America, Canada, Japan, Australia and New Zealand) and trade and aid with the developing countries of Asia and Latin America, in the hope of promoting closer economic cooperation and, perhaps, the establishment of a Pacific Free Trade Area.[2]

This paper examines, first, recent trends in the Pacific trade, based upon a trade matrix by country as well as by commodity group, and the intensity of trade among the five Pacific countries and their trade with Asian and Latin American developing countries. The analysis suggests that trade among the five Pacific countries has tended to become more inter-dependent, that there has been increased economic cooperation between those countries and, at the same time, that there are some weaker links which should be strengthened for further trade expansion.

Secondly, the possible static effects of eliminating tariffs among five Pacific countries are estimated on the basis of 1965

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[1]This paper is intended to revise and amplify the auother's former paper "A Pacific Economic Community and Asian Developing Countries," Hitotsubashi Journal of Economics, Vo. 7, No.1, June 1966, pp. 17-37

[2](See footnote on following page)

trade figures. The anticipated trade expansion would be extensive and larger than the effect of the Kennedy Round tariff reductions. This suggests that the formation of a Pacific Free Trade Area, if the five countries should so, would be effective in expanding trade, especially when the likelihood that another round of global tariff reductions may not be feasible in the coming ten to twenty years is taken into account. It is also shown how the gains from the elimination of tariffs would be distributed among the five countries and in what commodity groups the expansion of trade would be significant.

Thirdly, a proposal for a Pacific Free Trade Area seems quite premature for various reasons. More practical alternatives are proposed for intensifying closer trade partnership among the five Pacific countries and for increasing aid to and trade with developing countries in Asia and Latin America.

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[2] The devaluation of the pound sterling on November 18, 1967, and the uncertainty about the dollar which followed sterling devaluation, were a severe shock for Pacifc countries. They warned of the precariousness of international economic and financial co-operation within the framework of the IMF and GATT and the need for tighter international economic integration. Ten days before sterling devaluation, an important report was published by Maxwell Stamp Associates, (The Free Trade Option, Opportunity for Britain, The Atlantic Trade Study, London, 1967), strongly advocating the formation of a North Atlantic Free Trade Area among the United States, Canada, and Britain. The lessons of sterling devaluation suggest that the establishment of NAFTA will become an urgent task. Then, what course should Japan, Australia, New Zealand follow in the Pacific? The NAFTA plan treats them lightly: they may be permitted to participate as associate members. From our point of view, this hardly seems satisfactory. Why should the five Pacific countries, the United States, Canada, Japan, Australia, and New Zealand, not prepare for the formation of a Pacific Free Trade Area and welcome British participation? Might not PAFTA and NAFTA be linked together through common United States-Canadian participation?

II Recent Trends in the Pacific Trade

(1) Two centres in world trade

The Pacific is one of the two major centres of world trade and ranks alongside Western Europe. Trade among the five advanced Pacific countreis, the United States, Canada, Japan, Australia, and New Zealand, increased by 97 percent between 1958 and 1965, from $9.16 billion to $18.02 billion, and their share in world trade rose from 7.99 percent to 10.38 percent (Table 1).

The intra-areal trade of the EEC was $6.86 billion in 1958, which was smaller than PAFTA trade, and has tripled to $20.84 billion in 1965. The share of intra-areal trade of the EEC in world trade has increased from 5.98 percent in 1958 to 12.00 percent in 1965, more rapidly than in the PAFTA trade.

Taking the total trade among EEC, UK and other Western Europe as "European Trade," which has increased by 2.3 times from $22.23 billion in 1958 to $51.16 billion in 1965, or from 19.38 percent to 29.45 percent in the share of world trade, it is one of the most important and rapidly growing centres in world trade (see Table 2).

Within this, we can compare the "extended Pacific trade", which is the sum of the trade among countries in PAFTA, other Asia (excluding Mainland China) and Latin America. Extended Pacific area trade was $23.36 billion or 20.36 percent of world trade in 1958, which was somewhat larger than European trade, and has increased to $37.71 billion or 21.71 percent of world trade in 1965. Extended Pacific area trade is another centre of world trade, but it has not grown so fast as has European trade, mainly due to the stagnation in exports of primary produce from developing countries in Asia and Latin America.

The extended Pacific area could be the largest centre of world trade if there were closer cooperation in expanding trade and development within the area, since it has greater potential in the endowment of its population, natural resources, and capital awaiting development than already-well-developed Europe.

Furthermore, intra-areal trade amongst the five Pacific countries has increased more rapidly than their trade with outside countries. The ratio of intra-areal trade for the five Pacific countries taken together has increased from 32.5 percent in 1958 to 37.3 percent in 1965. In contrast, similar ratios for EEC were 30.1 percent in 1958 and 43.5 percent in 1965.

The five Pacific countries taken together have increased the share of their total exports going to Asia and Latin America from 19.3 percent in 1958 to 20.3 percent in 1965, and that to Europe as well from 26.7 percent to 27.9 percent respectively (Table 2). Thus, they have spread their expansion of trade to other areas. While the share of intra-areal trade in total European trade has increased from 53.3 percent in 1958 to 64.3 percent in 1965, the share of European trade both with the five Pacific countries and with Asia and Latin America has decreased from 13.6 percent to 12.4 percent and from 11.5 percent to 7.0 percent respectively. This seems to reflect the inward-looking trend of European trade, which has required Australia and New Zealand to turn their eyes back towards the Pacific area.

These trends may be shown more exactly by the intensity of trade indices.[1] As shown in Table 2 (C), the intensity of intra-area trade among the five Pacific countries is fairly high, 132 in 1958 and 133 in 1965, while that of intra-European trade is much lower, 106 in 1958 and 96 in 1965 (although that of intra-EEC trade is very high, 184 and 224 respectively-Table 3). The intensity of exports from PAFTA to ALA (Asia and Latin America) is high and increasing from 116 in 1958 to 147 in 1965, while that from Europe to ALA is low and decreasing from 63 to 45.

In short, extended Pacific trade is one of the most important and rapidly growing centres in the world trade and maintains a close trade relationship between the five Pacific countries and affiliated developing countries in Asia and Latin America.

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[1](See footnote on following page)

(2) PAFTA trade for each member country

The ratio of intra-area trade for the five Pacific countries taken together, as mentioned already, has increased from 32.5 percent in 1958 to 37.3 percent in 1965. The similar ratio for four countries has increased; from 25.2 percent to 31.0 percent for the USA, from 29.2 percent to 36.8 percent for Japan, from 27.5 percent to 33.3 percent for Australia, and from 22.8 percent to 23.5 percent for New Zealand; while it has decreased only for Canada from 63.0 percent to 60.1 percent (Table 4). The exceptional decrease in the Canadian ratio was due to her heavy increase of cereal exports to Socialist countries.

The importance of exports to Europe has increased for the USA from 25 percent in 1958 to 33 percent in 1965 and for Japan from 11 percent to 13 percent, while it has decreased for Australia from 50 percent to 35 percent, for Canada from 27 percent to 22 percent, and for New Zealand from 70 percent to 65 percent. Thus, we clearly see a growing importance of the Pacific trade for the five countries which has provided a new outlet for the three British Commonwealth countries.

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[1] The intensity of, say, Japan's export trade with another country is measured by the ratio of that country's share in Japanese exports to its total share in world imports. In symbols,

$$\frac{X_{ji}}{X_j} \bigg/ \frac{M_i}{W - M_j} \times 100,$$

where X_{ji} stands for Japanese exports to country i; X_j for total Japanese exports $(= \Sigma X_{ji})$; M_i for total imports by country i; M_j for total imports by Japan; and W for total world imports. It might be argued that the denominator of $M_i/(W-M_j)$ should be W, instead of $W - M_j$. However, this does not seem valid since Japanese imports do not constitute a demand for Japanese exports meaningfully. In the case of such an aggregated trade as the PAFTA and EEC, the formula should be

$$\frac{X_{pi}}{X_p} \bigg/ \frac{M_i}{W-(M_p - M_{pp})} \times 100,$$

where X_p and M_p stand for the total exports and imports of the PAFTA countries and M_{pp} for the intra-area imports (=exports) in the PAFTA: consequently $M_p - M_{pp}$ represents the imports of the PAFTA countries from the outside areas.

Taking the total exports (equals imports) of PAFTA trade as 100, the composition of intra-area trade as well as the importance of the trade with outside countries are shown in Table 5 and summarized in Figure 1. The share of Japan's exports in PAFTA trade has shown the most rapid rate of increase, rising from 9.2 percent in 1958 to 17.3 percent in 1965, and that of Australia has also increased from 5.0 percent to 5.8 percent, while the similar share has decreased for the USA from 49.2 percent to 47.1 percent, for Canada from 34.9 percent to 28.5 percent, and for New Zealand from 1.7 percent to 1.3 percent. The decrease in the American share was mainly due to the relative decrease of exports to Canada. The share of American exports to other three countries have increased. It is clear that Japan, Australia and the US have been the growth centres in the expansion of PAFTA trade while Canada and New Zealand have been weaker links.

These trends are shown further in Figure 1.[1] The share in the total PAFTA trade of Japanese imports and exports to each of the PAFTA countries has without exception increased. A similar trend can be seen in American and Australian trade with PAFTA countries other than Canada and New Zealand.

(3) Leading sectors in PAFTA trade

In order to carry out a commodity analysis of the PAFTA trade, trade matrices of eight commodity groups are calculated from UN, Commodity Trade Statistics for 1958 and 1965. The commodity groups are:[2]

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[1]Similar trends can be depicted by comparing over-time changes in the intensity of trade indices shown in Table 3.

[2]According to the revised classification of SITC, the coverage of commodity groups is as follows.

N_1 - goods: Division 04

N_2 - goods: Sections 0 (less 04) and 1, and 941.

N_3 - goods: Sections 2 (less 251, 266, 267, 27, 28) and 4.

N_4 - goods: Divisions 27 and 28, and Section 3 (less 351).

L_1 - goods; Sections 6 (less 66, 67, 68, 69) and 8 (less 812, 821, 86), and 267, 665, 666, 667.

L_2 - goods: 541, 69, 733, 812, 821, 86, 951, 961.

C_1 - goods: Section 5 (less 541) and 251, 266, 351, 66 (less 665, 666, 667), 67, 68.

C_2 - goods: Section 7 (less 733).

N_1 - goods: staple foods (rice, wheat, and other grains).
N_2 - goods: other foodstuffs, including processed goods.
N_3 - goods: agricultural raw materials.
N_4 - goods: minerals, metals, and fuels.
L_1 - goods: labor-intensive goods of light industry, both intermediate and final products.
L_2 - goods: labor-intensive final goods of heavy and chemical industry origin (cameras, sewing machines, bicycles, precision type equipment, medicine, etc.)
C_1 - goods: capital-intensive intermediate goods of heavy and chemical industry origin (pig-iron, steel, chemical fibres, fertilizer, etc.).
C_2 - goods: capital intensive heavy machines and equipment.

Further, N_1-and N_2-goods are aggregated as Food, N_3- and N_4-goods as Raw Materials, L_1- and L_2-goods as Light Manufactures, and C_1- and C_2-goods as Heavy Manufactures and Chemicals, for the convenience of analysis.

The composition of PAFTA trade for each country exhibits different characteristics. In Japanese trade with PAFTA countries in 1965, 94.8 percent of exports were manufactures while 71.1 percent of imports were primary products. Japan's trade is mainly vertical type, specializing in exports of manufactured goods. Australia and New Zealand maintain another type of vertical trade, specializing in exports of primary products: 80.0 percent of exports were consisted of primary products in the case of Australia and 82.4 percent in the case of New Zealand, while imports were 88.2 percent and 84.6 percent in manufactured goods respectively. The United States and Canada maintain a balance in the trade of manufactures as well as primary products between exports and imports: manufactured goods occupy 70.0 percent both in exports and imports for the US and 60.5 percent and 79.6 percent in exports and imports respectively for Canada. It is to be expected, therefore, that the two countries should conduct horizontal type trade with the PAFTA countries.

Relative to the growth of total PAFTA trade from 100 in 1958 to 197 in 1965, trade in heavy manufactures and chemicals (C-goods) has grown fastest (264) and followed by the trade in light manufactures (200) in which, however, the more sophisticated ones (L_2-goods) have grown almost as fast as C-goods (252), while the trade in food and raw materials has grown at a slower rate than total trade (181 and 173 respectively) (see Table 6). Heavy manufactures and chemicals as well as sophisticated labor intensive goods have been the leading sector in PAFTA trade, with food, raw materials and traditional light manufactures (L_1-goods) the lagging sector.

Figures 2 clearly shows that the importance of bilateral trade in C-goods (the total share in PAFTA trade was as large as 46.5 percent in 1965) has rapidly increased in almost all directions except in three unimportant cases, i.e., Australia → the U.S., New Zealand → Australia, and New Zealand → Canada. The U.S. and Japan are in export surplus while Canada, Australia and New Zealand are in import surplus. In L-goods (the total share was 20.6 percent), except in only one case (Canada → the U.S.), the importance of bilateral trade has also increased in all directions (Figure 3). Only Japan is in heavy export surplus while the other four countries are in import surplus.

Raw materials are as important as L-goods in PAFTA trade, the total share being 20.5 percent (Figure 4). The U.S. and Japan are net importing countries while Canada, Australia, and New Zealand net exporting countries. The most significant change during the period of 1958 - 1965 was the increase of importance in Australian exports to Japan, the U.S., and Canada and the decrease in bilateral trade between the U.S., and Canada.

Food is the least important commodity category (11.3 percent) in PAFTA trade, and only Japan is a net importer (Figure 5). The most significant change was the decrease in importance of trade between America and Canada.

The expansion of horizontal trade in manufactured goods can be regarded as the primary acceleror of rapid growth and prosperity of the EEC's intra-bloc trade[1] (Table 7). In order to ascertain whether or not similar progress in horizontal trade between the PAFTA countries has been taken place, the degree of horizontal trade[2] is calculated (Table 8).

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[1]Kiyoshi Kojima, "The Pattern of International Trade Among Advanced Countries," Hitotsubashi Journal of Economics, June 1964, pp. 24-26.

[2](See footnote on following page)

i) The aggregate degree of horizontal trade within PAFTA for all commodities, $\overline{D}_T$, in 1965, was high in the case of the U.S. and Canada, 54.8 and 50.3 respectively, while that of Japan (24.1), Australia (20.4) and New Zealand (13.8) was low. In bilateral trade, $\overline{D}_T$ was high only in the American-Canadian trade (47.2) and low in all other bilateral trading, spreading from 30.2 to 5.2. The higher figures compare well with intra-areal trade in the EEC which, however, has no lower degree even in bilateral trade.

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[2]The degree of horizontal trade between two countries for a certain commodity category (denoted by D) is calculated as follows: where country A's imports of commodity h from country B is A_h and country B's imports of the same commodity h from country A is B_h :

$$D = \frac{B_h}{A_h} \times 100, \qquad \text{if } A_h > B_h$$

or

$$D = \frac{B_h}{A_h} \times 100, \qquad \text{if } A_h < B_h .$$

The degree of aggregate horizontal trade (denoted by $\overline{D}$) can also be calculated as the weighted adverage of D of several commodities by using as weights the percentage ratio of the total of A_h and B_h in the total trade of the two countries, or it is shown as follows:

$$\overline{D} = \Sigma \frac{B_h}{A_h} \cdot \frac{A_h + B_h}{M_A + M_B} \qquad (\text{if } A_h > B_h)$$

$$+ \Sigma \frac{A_h}{B_h} \cdot \frac{A_h + B_h}{B_A + M_B} \qquad (\text{if } A_h < B_h),$$

where M_A represents country A's total imports from country B and M_B, country B's total imports from country A.

The degree of horizontal trade is always less than 100 and the closer it is to 100, the further the horizontal trade is carried out and balanced within the same commodity category or aggregate categories.

ii) In the EEC, the degree of horizontal trade has rapidly increased in general from 1956-58 and 1965 (Table 7). In PAFTA trade, the degree has increased from 1958 to 1965 in bilateral trade among the U.S., Canada and Japan, while it has decreased in Australia-PAFTA, Australia-America, New Zealand-PAFTA, New Zealand-Canada, and New Zealand-Japan trade.

iii) In the degree of horizontal trade by commmodity (D), the higher figures and/or those which show the most significant increase are to be found in heavy manufactures and chemicals (C_1 and C_2) among the trade of the U.S., Canada and Japan; for example, in C-goods it has increased from 22 in 1958 to 43 in 1965 in American-Canadian trade, from 22 to 54 in American-Japanese trade, and from 43 to 69 in Canadian-Japanese trade. These higher degrees of horizontal trade in heavy manufactures and chemicals are equivalent to those in EEC. The trade of Australia and New Zealand in this commodity category is low and decreasing in the degree of horizontal trade with other PAFTA countries.

iv) Higher degrees of horizontal trade in raw materials (R-goods) are shown in the trade of America-Canada, America-Australia, Canada-Australia, Canada-New Zealand, and Australia-New Zealand. The promotion of horizontal trade in raw materials between the PAFTA countries, except Japan, would be fruitful. In food (F-goods), horizontal trade has not progressed except in the trade of America-Canada and Australia-New Zealand.

In short, horizontal trade between PAFTA countries, with the exception of American-Canadian trade, is not well developed relative to that of the EEC. This would suggest us that there is a plenty of room to expand PAFTA trade through the promotion of horizontal trade, particularly in heavy manufactures and chemicals, and raw materials as well.

(4) Summary

The analysis of recent trends in the Pacific trade suggests to us, first, that trade between the five Pacific countries (USA, Canada, Japan, Australia, and New Zealand) has been growing rapidly, and interdependence has intensified. This provides a foundation for moving towards closer economic co-operation and, perhaps, integration.

Secondly, although extended Pacific trade had the same scale as European trade in 1958, the latter has gone ahead of the former since then. This suggests a need of closer economic co-operation in the extended Pacific region which possesses hugh potential for economic development.

Thirdly, the growth centres of the PAFTA trade have been Japan, Australia and U.S.A., while Canada and New Zealand have been lagging behind. Heavy manufactures and chemicals, as well as sophisticated light manufactures, have been leading sectors in trade expansion, while trade in primary produce and traditional light manufactures has been relatively stagnant. Differences by commodity in the growth of trade has a close relation to the growth rate of each country's trade.

These trends suggest the main policy targets for further expansion of the Pacific trade.

III Static Effects of PAFTA

The formation of a Pacific Free Trade Area would, in fact, bring about more comprehensive trade liberalization amongst participating countries, with the elimination of tariffs on a substantial proportion of their commodity trade, and would result in a larger trade expansion than is possible through tariff reductions of the Kennedy Round type. Complete regional trade liberalization would appear to have considerable advantages over partial trade liberalization in world markets. This is especially true if, as is most probable, another major round of global tariff reductions is not feasible within the next ten or twenty years. In that event, the formation of PAFTA would seem an effective alternative for mutual trade expansion among the five advanced Pacific countries.

(1) Effects of Tariff Elimination in PAFTA

Here an attempt is made to estimate the impact of the elimination of tariff upon the five Pacific countries which might constitute a Pacific Free Trade Area, on the basis of 1965 trade figures. The method of the estimation is the same as that used in the author's former paper[1] based on the 1963 trade figures.

[1](See footnote in the following page)

The impact effect of Pacific tariff elimination would be to increase trade by $5,000 million. This represents an expansion of 28 percent on intra-areal trade, or 10.3 percent on Pacific country exports to, and 11.9 percent on imports from the whole world. In other words, there would be significant trade expansion. (Table 9)[2]

The gains from tariff elimination would not be equally distributed amongst the five Pacific countries involved. Japan's exports would increase by $1,740 million, or 56 percent on her total exports to PAFTA countries, and her imports would increase by $430 million, or 14.7 percent on her total imports from PAFTA countries. Japan's trade balance with the Pacific, which was roughly in equilibrium in 1965, would consequently improve by $1,310 million. United States' exports would increase by $2,300 million, or 27.9 percent, and imports by $2,280 million, or 30.1 percent, and the favourable balance in United States' trade with the Pacific, of about $850 million in 1965, would be preserved. On the other hand, imports would rise more rapidly than exports for the remaining three countries. Canada's exports would increase by $855 million but her imports would rise by $1,480 million; Australia's exports would increase by $65 million, whereas her imports would rise by $650 million; and New Zealand's exports would grow by $22 million, whilst her imports would rise by $140 million.

The differential pattern of gains depends principally upon whether the country's exports are more or less heavily concentrated in manufactures, and suggests a need for fostering further industrialization in Canada, Australia, and New Zealand. Indeed, the pursuit of this objective would be facilitated through the dynamic effects of establishing a larger and completely free regional market, and through the freer movement of capital, technical know-how, and managerial

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[1]Kiyoshi Kojima, "A Pacific Economic Community and Asian Developing Countries," Hitotsubashi Journal of Economics, June 1966, pp. 23-26.

[2]It was estimated that the increase would be $3,183 million or 23 percent of the total intra-area trade in 1963 (Kiyoshi Kojima, ibid., pp. 23-24). A greater increase in 1965 than in 1963 is due to the faster expansion in manufactured trade than in trade of primary products during that period.

skills among member countries. The most important fact to be noted, however, is that the expansion of intra-areal trade would be large if the five countries could effect tariff elimination.[1]

As shown in Table 10, in terms of intra-areal trade in 1965, the increase of trade in food and raw materials would be limited (4.5 percent and 2.0 percent respectively) while that of light manufactures as well as heavy manufactures and chemicals would be considerable (40.8 percent and 39.5 percent respectively). This is also true for each country. These results are as might be expected since existing tariffs and elasticities of demand are low for primary products and high for manufactures. Thus, the elimination of tariffs would promote trade in manufactures of the area as a whole and bilateral horizontal trade, but it would not stimulate to the same degree trade in primary products. These differences result from a variety of effects in each country along the lines mentioned above.

How the trade balance between each pair of countries would change is also shown in Table 9. Japan would improve her trade balance with all four countries in the area; the United States would do the same with three countries, except Japan; Canada's trade balance would deteriorate with the United States and Japan, while improving with Australia and New Zealand; Australia's would deteriorate with three countries, except New Zealand; and New Zealand's would deteriorate with all four countries. These results, as mentioned already, depend upon the degree of concentration of exports in manufactures or in primary products respectively.

In view of close trade ties and greater possibilities for increasing trade through the reduction or elimination of tariffs, a Pacific Free Trade Area among the United States, Canada, Japan, Australia, and New Zealand offers a target worth studying, although it presents a number of problems which need to be solved before its establishment.

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[1] Trade diversion effects are not estimated here. If these are included, the expansion of PAFTA trade would be much larger than our estimates show.

The estimation of the effects of trade liberalization makes some of these problems clear:

(i) Although the establishment of PAFTA would result in a sizeable expansion of intra-areal trade as a whole, the distribution of gains between the exporting and the importing countries of manufactured goods would be so unequal that no consensus towards the establishment of the PAFTA would be obtainable. Before its establishment, concerted actions of the PAFTA countries to promote export-oriented industrialization of Canada, Australia, and New Zealand would be needed.

(ii) As shown in Table 10, heavy manufactures and chemicals would expand remarkably due to the elimination of tariffs both in exports and imports in all the five Pacific countries. The promotion of horizontal trade within the area in these commodities should be the primary goal sought by the five countries whether through the establishment of PAFTA or through alternative measures. These industries can realize the largest dynamic effects through the enlargement of markets and through the freer movement of capital, technical and managerial know-how beyond national frontiers. These dynamic effects would work more favorably for the relatively small countries which have abundant natural resources. It should be noted that the freer movement of capital in this area is much needed in order to promote horizontal trade in heavy manufactures and chemicals.

(iii) It is estimated that trade in raw materials will expand by a very small percentage (2.0 percent in the PAFTA as a whole), but greater potential for expansion of this trade can be expected, particularly in the exports of mineral products from Australia and Canada. Further expansion of heavy and chemical industries in the Pacific region would require a rapid development of trade in raw materials and intermediate goods within the area. The import surplus of Canada, Australia, and New Zealand in heavy manufactures and chemicals would be covered by the export surplus from them in raw materials. In agricultural raw materials, however, room for exporting should be provided to developing countries as far as they can produce them competitively.

(iv) In the trade of light manufactures, the rate of increase due to liberalization would also be large(40.8 percent in the PAFTA as a whole, but only Japan would enjoy a net increase in exports. Requests for protection of these light manufacturing industries in the U.S., Canada, Australia and New Zealand, mainly for the purpose of maintaining full employment, are so strong at this stage that to abolish trade barriers in this sector would encounter a number of difficulties. Moreover, all PAFTA countries ought to provide free access for developing countries' products of this type. How to foster structural adjustment in this sector for the five Pacific countries as a whole by taking into consideration the expansion of trade with developing countries in Asia and Latin America would be an important but difficult problem.

(v) The elimination of tariffs in itself would not change greatly trade in foodstuffs (expected increase being limited to 4.5 percent), since a number of non-tariff restrictions exist either openly or covertly. Protectionism for agriculture is unreasonably strong, especially in Japan and the United States. Should these protectionist attitudes be rationalized, however, PAFTA trade in food offers much scope for expansion through mutual readjustment. Here, too, attention should be paid to the interests of developing countries.

Thus, the five Pacific countries should take measures to expand production and trade of heavy manufactures and chemicals as well as raw materials, on the one hand, and, on the other, measures to readjust production and trade of light manufactures and food. Also they have to take into consideration readjustments for increasing trade with developing countries in Asia and Latin America. It might be best to concentrate on the expansion of production and trade in heavy manufactures, chemicals, and raw materials and refrain from pushing the abolition of protectionism in light manufacturing and agriculture, as a first step towards wider Pacific integration. If the expansion of growing sectors is sufficiently large and rapid, readjustments in the lagging sectors will follow smoothly without so much trouble. For this reason, the sectoral free trade approach has much to recommend it as a first step.

In order to expand harmonious production and horizontal trade in these growth sectors within the Pacific area, the elimination of tariffs should work effectively but it alone will not be enough, and a supplementary measures will be required. The free movement of capital and provision of larger markets or, in other words, the dynamic effects of economic integration shoul be promoted specifically.

(2) Effects of Global Tariff Reductions

It is beyond our capacity for the time being, although admittedly very important, to estimate rigorously the effects of the Kennedy Round negotiations concluded in June 1967. Here a very rough estimation is attempted in order to show that even the largest global tariff reduction of the Kennedy Round scale would bring about a much smaller expansion of trade for the five Pacific countries than the establishment of the PAFTA.

In making this estimate, it is assumed, first, that the elasticity of imports (and exports) with regard to the reduction of tariff is the same as what adopted for each country's trade with the PAFTA. Secondly, the rate of tariff reductions was 100 percent in the case of PAFTA, while it is assumed here to be 25 percent for food, 30 percent for light manufactures, and 35 percent both for raw materials and for heavy manufactures and chemicals, for the Kennedy Round negotiations. Thirdly, it is assumed that all the countries in Europe, i.e., the United Kingdom, EEC and other Western Europe, reduce tariffs.

Because of these assumptions, the estimation would result in an over-valuation of the actual effects of the Kennedy Round tariff reductions. Our estimates indicate the maximum effect of the global tariff reductions which are likely to be realized. Results of the estimation are shown in Table 11.

Firstly, it should be noted that the rate of increase in trade due to tariff reductions is far larger in the case of the formation of PAFTA than in the case of the Kennedy Round. In the former case, the total intra-areal trade of the five Pacific countries in 1965 would increase by 10.3 percent and 11.9 percent respectively for total exports to and imports from the world, while in the latter case by 5.5 percent[1] and 7.7 percent respectively. This suggests to us that a complete regional trade liberalization would be better than partial free trade in respect of the world market for the five Pacific countries as a whole and for each of them.

Secondly, balance of payments effects too would be more advantageous in the case of PAFTA than in the case of global

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[1](See the footnote in the following page)

tariff reductions. In the former case, the balance of increments between exports and imports would be zero for the five Pacific countries taken together, while it would be in deficit by $600 million in the latter case. For each country, it may be better to compare in both cases the ratio of imbalance to the sum of incremental exports and imports. The ratio would be 60.4 percent in the case of PAFTA and 45.4 percent in the case of global tariff reductions for Japan, 0.4 percent and -7.2 percent for the U.S., -26.8 percent and -27.6 percent for Canada, -82.0 percent and -85.4 percent for Australia, and -72.7 percent and -73.9 percent for New Zealand. These disadvantageous trade balance effects in the case of global tariff reductions are due to the fact that a group of countries (i.e., developing countries and socialist countries) does not reduce tariffs but is allowed a "free ride" on the Pacific countries' tariff reductions. The more favorable effects of establishing PAFTA as compared with global tariff reductions should be closely noted by the five Pacific countries, particularly in view of the prospect that another global negotiation of tariff reductions as large as the Kennedy Round scale would not take place in the coming ten to twenty years.

(3) The Choice for Japan

The best choice for Japan is to expand and free mutual trade with every trading region. The present stage of her industrialization, her dual pattern of trade with developed and

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[1] The rate of increase in a country's exports is proportional to (a) the rate of tariff reductions and (b) the coverage of area which reduces tariffs for the country's exports. Let γ_F and γ_G stand for the rate of tariff reductions in the case of free trade area and of global negotiation respectively, and χ_F and χ_G for the share in a country's total exports to the free trade area and to the countries which reduce tariffs outside the free trade area in global negotiation respectively. Then, according as $\chi_F/(\chi_F + \chi_G)$ is greater than, or equal to, or smaller than γ_G/γ_F, the increase of a country's exports in the case of free trade area is greater than, or equal to, or smaller than that in the case of global tariff reductions. For the five Pacific countries taken together, in 1965, $\chi_F = 0.37$, $\chi_G = 0.28$ and $\chi_F/(\chi_F + \chi_G) = 0.57$. This is greater than $\gamma_G/\gamma_F = 0.3/1$, and therefore, the establishment of PAFTA would bring about a greater gain of exports than in the global tariff reductions of the Kennedy Round scale.

developing countries, and her geographical location dictate such a choice.[1] However, if a further global tariff reduction is not expected to be feasible in the near future and if, moreover, the compartmentalization of world trade is promoted further, it would be a serious concern for Japan to devise measures for expanding trade on an assured basis through establishing the Pacific Free Trade Area or some other alternative.

The establishment of PAFTA would bring the largest gain to Japan among the five Pacific countries. Japan's exports would increase by $1,740 million or 20.0 percent of her total exports and her balance of trade with the area would improve by $1,310 million. These gains would be far greater than in the case of global tariff reductions of the Kennedy Round scale which would increse Japan's exports by 8.8 percent.

The big gains for Japan from the establishment of PAFTA derive, firstly, from the fact that Japan's exports depend as much as 37 percent upon the PAFTA markets. European markets are not important (13 percent) for Japan.

Secondly, about 95 percent of Japan's exports to other Pacific countries are manufactures which would enjoy a greater expansion from trade liberalization, while about 71 percent of Japan's imports are primary products, which would not increase very much in consequence of reductions.

When the time comes for Japan to consider economic integration, it should be a Pacific Free Trade Area. Japan is destined by geography to participate in political arrangements in the Pacific rather than in Europe. Moreover, economic integration without the United States, whose importance for Japan's market is as large as 30 percent, offers lesser incentive for Japan to join.

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[1] Kiyoshi Kojima, "Trade Arrangements among Industrial Countries: Effects on Japan," in Bela Balassa, Studies in Trade Liberalization, The Johns Hopkins Press, Baltimore, 1967, p. 211.

Thus, Japan would benefit from the establishment of PAFTA, or from some other alternative, through the cheaper import of raw materials and other primary products, the expansion of her exports of light manufactures, and the promotion of horizontal trade in heavy manufactures and chemicals.

The formation of PAFTA or some other alternative for economic co-operation among the five Pacific countries is desired by Japan for another reason. Collective measures by the group are especially desirable for assisting economic development and trade growth in Southeast Asian countries.

Asian markets are very important for Japan relative to other Pacific advanced countries. The share of Asia (excluding Mainland China) in Japan's total exports is as large as 26 percent, though it has been decreasing. Japan cannot disregard the interests of developing countries, especially in South and Southeast Asia, and the same applies to the United States vis-à-vis Latin America. The question is often raised: should Japan rely on the rapidly increasing but competitive markets in developed countries, or on the complementary but more slowly expanding markets in developing countries? She has, in fact, to expand trade in both directions.

If the five Pacific countries were to establish PAFTA, they should welcome as associated members those developing countries in Asia and Latin America who wish to join. Or, they might provide general preferential tariffs[1] in favor of the developing countries. Moreover, the five Pacific countries should provide assistance more efficiently and on a larger scale to foster structural adjustment in their own industries in order to open wider markets for developing countries products. Concerted policy measures among the five Pacific countries are urgently required.

In this context, Japan's attitude towards Mainland China present a problem. Political, military, and ideological troubles aside, however, it is obvious that main supply sources of natural resources and profitable markets for Japan are not the Asian mainland but the extended Pacific region.

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[1]See, Kiyoshi Kojima, "General Preferences to Developing Countries : A Japanese Assessment," <u>The Malaysian Institute of Management Journal</u> (forthcoming).

Although it seems to be quite beneficial for Japan to establish the Pacific Free Trade Area, there is hesitation and/or caution in Japan about stepping out in that direction. One of the reasons for hesitation is heavy protectionism for agriculture which needs time to be rationalized. The other is fear about the penetration and domination of American capital. These difficulties and worries should be remedied from a wider view point of economic co-operation within the extended Pacific region.

IV Closer Pacific Trade Partnership

At this stage, the PAFTA proposal seems premature, unless there is some further unforeseen disturbance in the free world economy. It is as yet neither economically nor politically feasible. Firstly, American interests are presently worldwide and the United States could not participate readily either in a Pacific or an European regional grouping. For the moment, the United States appears committed to a global non-discriminatory approach to freer trade.[1]

Secondly, the five Pacific countries still lack the solidarity and degree of integration that would be necessary for dispensing with protective measures for the main sectors of their economies involved in regional trade - the labour-intensive industries in some countries, the agricultural and pastoral industries in other countries.[2]

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[1] Cf. John W. Evans, U.S. Trade Policy, New Legislation for the Next Round, Council on Foreign Relations, 1967. Alfred C. Neal, "Economic Necessities and Atlantic Communities," Foreign Affairs, July 1967. William Diebold, Jr., "Doubts about Atlantic Free Trade," The Round Table, October 1967. William Diebold, Jr., "Future Negotiating Issues and Policies in Foreign Trade," Issues and Objectives of U.S. Foreign Trade Policy, Joint Economic Committee, Congress of the United States, September, 1967.

[2] A comment against PAFTA is presented by H.W. Arndt, "PAFTA: An Australian Assessment," Intereconomics, Hamburg, October 1967, to which there is a reply by Kiyoshi Kojima, "A Pacific Free Trade Area: Reconsidered," ibid. (forthcoming).

Thirdly, the static gains from complete trade liberalization would differ widely from one country to another because of the disparity in stages of industrialization within the region.

However, the realization of PAFTA might be precipitated by a shock which came from outside the area. Greater European integration between EEC and EFTA could produce an "inward looking" Europe whereupon the United States might well find closer integration in the Pacific desirable and necessary. Should the United Kingdom fail again to join the EEC, she might probe, the establishment of a North Atlantic Free Trade Area with the United States and Canada.[1] In the case, Japan, Australia and New Zealand might have to consider seriously their own integration. Moreover, PAFTA and NAFTA might be linked together through the U.S. and Canada which would belong to the two free trade areas.[2]

Economic integration in the Pacific, should be a free trade area instead of a customs union or political union. A free trade area arrangement would have advantages over the alternatives from several points of view: it is consistent with the rules of the General Agreement on Tariffs and Trade; it preserves the autonomy of members with respect to their tariff policies vis-à-vis non-participants; and it is a purely commercial arrangement, carrying no obligation for eventual

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[1]Maxwell Stamp Associates, The Free Trade Area Option, Opportunity for Britain, the Atlantic Trade Study, London, 1967. Theodore Geiger and Sperry Lea, "The Free Trade Area Concept as Applied to the United States," Looking Ahead, National Planning Association, Washington, October 1967.

[2]If NAFTA is instituted among the U.S., Canada and Britain while PAFTA is not, Japan should join the former since otherwise she would suffer from large-scale trade diversion. It is estimated that "the UK would capture about 10 percent of Japanese trade (say about $225 million) in North American markets, if Japan were not in NAFTA." (Maxwell Stamp Associates, The Free Trade Area Option, ibid., p. 44). Since the NAFTA proposal aims at freeing of non-agricultural trade, Australia and New Zealand would be less interested in joining (Ibid., p. 38). Both for NAFTA and PAFTA, a crucial question is: "Would the Americans accept the free trade area concept of a new Grand Design?" (Ibid., p. 78).

political federation or union.[1]

Whether or not a free trade area can ultimately be established, the five advanced Pacific countries should now set about establishing closer and more profitable trade partnerships with each other. To date, the United States has tended to look toward the possibility of ultimately 'going in with Europe', and has tended to neglect the Pacific region. The flow of financial resources and direct investment from America to Pacific basin countries, including Asian and Latin American countries, has lagged behind that going to Europe.[2] The Pacific, Asian, and Latin American region has a huge potential for trade growth and development compared with Europe, and it should be looked at more closely.

Studies and proposals about Pacific trade expansion have been quite limited. However, recently a movement in this direction has been initiated. The Canada-United States Automotive Agreement has taken effect from January, 1965. This should be given much attention as a pioneer of selective

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[1]See, Harry G. Johnson, "Proposals for a North Atlantic Free Trade Area," an address to the European-Atlantic Group, 6 March 1967, pp. 4-5, Canadian-American Committee, A Canada-U.S. Free Trade Arrangement, Survey of Possible Characteristics, October 1963. Ditto., A Possible Plan for Canada-U.S. Free Trade Area, A Staff Report, February 1965. Ditto, A New Trade Strategy for Canada and the United States, May 1966.

[2]The financial resources flows from developed to developing countries in 1964 were $8.51 per capita for Africa, while they were $3.92 for Latin America, $2.85 for South Asia, and $3.88 for Far East. The last one was, however, very small if aid to South Vietnum is excluded. (OECD, Geographical Distribution of Financial Flows to Less Developed Countries, 1966.)

The U.S. Direct foreign investments, amounting to $49,328 million at the end of 1965, have directed mainly to Canada (30.9 percent), EEC (12.8 percent) and other Europe (15.6 percent), while Oceania (3.7 percent) and Japan (1.4 percent) have benefited not only very limited amount but also in slower increase relative to Europe (US Department of Commerce, Survey of Current Business, September 1967).

industrial integration.[1] The Australia-New Zealand Free Trade Agreement began in January 1966.[2] The Pacific Basin Economic Co-operation Committee was established among business circles of the five Pacific countries in April 1967; and a number of bilateral co-operative activities have been promoted in business circles. It should be noted also that Mr. Takeo Miki, Japan's Foreign Minister, is keenly interested in promoting economic cooperation in the Pacific and Asian region.

Before the establishment of PAFTA, several steps towards closer Pacific economic co-operation might be practicable immediately. Five main objectives suggest themselves:

1. To increase the flow of financial resources from the United States to other Pacific countries, as well as to Asian and Latin American developing countries.

2. To stimulate horizontal trade among the five advanced Pacific countries in heavy manufactures and chemicals and to expand production and trade of raw materials and intermediate goods more efficiently for the region as a whole.

3. To readjust production and trade in agricultural commodities among the five Pacific countries, taking into consideration their relationship with Asian and Latin American developing countries.

4. To readjust production and trade of light manufactures, which are labour intensive, with the aim of providing greater access for Asian and Latin American countries in advanced country markets.

5. To co-ordinate the aid policy of the five advanced Pacific countries towards Asian and Latin American developing countries.

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[1]See, Sperry Lea, "Free Trade by Sectors," NPA, Looking Ahead, September 1966.

[2]F.W. Holmes, "Australia and New Zealand in the World Economy", The Economic Record, March 1967.

Practical steps towards closer Pacific economic co-operation can be taken by strengthening functional, rather than institutional integration, and thus attempting to attain the favourable benefits of a free trade area whilst avoiding the unfavourable impact effects. To realize these objectives, I suggest the initiation of three codes of international behaviour and the formation of two new regional institutions.

1. A code of good conduct in the field of trade policy, under which countries would relinquish the right to raise tariffs or impose other forms of trade restriction,[1] and would gradually reduce those trade barriers particularly on the import of agricultural products and labour intensive light manufactures, should be promulgated.

2. A code of overseas investment to promote mutual investment among the five advanced Pacific countries, most effectively from the United States, and to foster the activity of joint ventures is much needed to promote trade expansion, especially horizontal trade expansion in heavy manufactures,[2] and for the development of the vast mineral resources of the Pacific region. A code which minimises the fear of American capital domination and maximises protection for America's balance of payments would greatly facilitate overseas investment and the better allocation of regional resources.

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[1]The assurance against the reimposition of duties in a free trade area would induce enterprises to expand trade and investment abroad. The code of good conduct would reduce uncertainty in international trade and be a partial substitute for the formation of free trade area. See, Bela Balassa, Trade Liberalization Among Industrial Countries, Council on Foreign Relations, 1967, pp. 160-161.

[2]N.P.G. Elkan suggests an interesting scheme for promoting horizontal trade in his article, "How to Beat Backwash: The Case for Customs-Drawback Unions," Economic Journal, March 1965. His plan may be applicable to trade between small economies like Australia and New Zealand but would be too cumbersome to work in wider markets. It seems to me that horizontal trade would be fostered most efficiently through the expansion of joint ventures and other private capital's activities.

3. A code of aid and trade policies towards associated developing countries is also required, so that Asian and Latin American countries might enjoy the benefits of larger markets for their agricultural products and light manufactures. The flow of developmental aid must be increased, appropriate aid projects selected, and domestic industrial structures adjusted to meet the legitimate trade needs of affiliated less developed countries.[1]

An organization for Pacific Trade and Development (OPTAD) should be established in order to give effect to these codes of international behaviour. Its main features would be similar to those of the OECD, and it could be structured in the same way, with three committee on trade, investment, and aid.[2]

Further, a Pacific Bank for Investment and Settlement would be established with the aim of facilitating investment and settlement within the Pacific, Asian, and Latin American region, and equipped with a mechanism for preventing the drainage of gold from the United States.[3]

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[1] See. Kiyoshi Kojima, "A Proposal for International Aid," The Developing Economies, December 1964. Ditto, "Japan's Role in Asian Agricultural Development," The Japan Quarterly, April-June, 1967.

[2] Aid Committee could be set up first because of urgency for increasing aid and trade with developing countries.

[3] This topic will be further developed by Ashiya's paper presented to the conference. My own thought was shown in Kiyoshi Kojima, "A Proposal for Increasing International Liquidity, " The Oriental Economist, Aug., 1964, which was reviewed in "How Aid Could be United," The Economist (London), July 25, 1964, pp. 401-402.

TABLE 1 Trade Matrix (million dollars)

upper column, 1958
middle column, 1963
lower column, 1965

Exports to / Exports from	a USA	b Canada	c Japan	d Australia	e N.Z	f Pacific C.	g Other Asia	h Latin Am.	i U.K	j EEC	k Other W.E	Total Exports
a. USA		3,426.8 4,130.7 5,602.2	843.8 1,716.7 2,060.9	190.1 445.6 698.7	43.3 71.8 126.1	4,504.0 6,364.8 8,487.9	1,384.1 2,541.9 2,689.7	4,073.2 3,156.2 3,750.7	838.5 1,172.9 1,592.3	2,428.5 4,011.8 4,973.8	1,211.2 1,794.2 2,194.2	17,904.3 23,393.0 27,400.0
b. Canada	3,021.1 3,643.2 4,671.7		108.8 276.3 293.4	54.6 94.3 132.8	15.9 28.8 34.4	3,200.4 4,042.6 5,132.3	139.0 126.1 142.8	189.9 236.3 249.1	805.6 941.3 1,096.5	438.0 451.8 588.2	142.3 194.8 234.8	5,081.6 6,779.0 8,534.0
c. Japan	692.5 1,522.4 2,517.1	76.3 124.8 214.6		62.6 158.5 319.3	7.4 43.8 61.2	838.8 1,849.5 3,112.1	877.2 1,617.8 2,190.5	193.7 315.0 404.7	105.2 155.8 205.1	124.0 331.8 484.1	97.5 230.4 407.0	2,876.9 5,453.0 8,452.0
d. Australia	96.7 320.2 327.4	29.8 52.5 41.6	205.2 483.3 495.2		125.9 178.7 188.3	457.6 1,034.7 1,052.5	149.9 272.8 315.9	12.1 15.7 29.2	491.6 501.3 524.6	302.7 404.2 430.1	40.9 75.2 92.6	1,663.7 2,788.0 2,978.0
e. New Zealand	104.1 156.9 124.5	11.4 12.6 13.8	15.4 44.2 51.7	28.8 47.5 46.8		159.7 261.2 236.8	6.3 16.4 16.8	1.2 2.4 4.1	389.5 413.6 484.5	99.1 153.5 156.1	7.4 6.1 10.3	700.2 910.0 1,007.0
f. Pacific Count.	3,914.4 5,642.7 7,640.7	3,544.3 4,320.6 5,872.2	1,173.2 2,520.5 2,901.2	336.1 745.9 1,197.6	192.5 323.1 410.0	9,160.5 13,552.8 18,021.7	2,556.5 4,575.0 5,355.7	4,470.1 3,725.6 4,437.8	2,630.4 3,184.9 3,903.0	3,392.3 5,353.1 6,632.3	1,499.3 2,300.7 2,938.9	28,226.7 39,323.0 48,371.0
g. Other Asia	972.8 1,187.4 1,493.4	79.0 117.9 140.6	548.0 972.0 1,105.2	230.8 141.4 177.0	38.7 45.8 50.0	1,869.3 2,464.5 2,966.2	2,106.3 1,297.4 1,342.6	121.3 92.6 87.9	957.1 892.7 847.1	702.2 762.7 827.8	159.0 243.8 267.9	6,756.0 7,850.0 8,600.0
h. Latin America	3,593.9 3,345.2 3,617.5	115.7 305.3 361.8	161.3 368.7 431.5	4.0 11.2 9.9	1.1 10.6 3.6	3,876.0 4,041.0 4,424.3	28.0 64.3 58.5	737.1 740.6 1,016.3	673.3 705.9 657.8	1,255.8 1,951.4 2,164.0	406.5 527.2 717.2	8,154.9 9,190.0 10,400.0
i. United Kingdom	828.0 1,016.7 1,454.6	541.9 502.5 582.3	56.7 142.8 148.2	664.9 665.9 793.1	361.1 324.3 352.7	2,452.6 2,652.2 3,330.9	1,041.3 1,128.3 1,132.6	427.4 397.7 410.4		1,294.8 2,499.9 2,744.3	1,676.4 2,499.9 2,928.2	9,392.1 11,857.0 13,710.0
j. EEC	1,669.6 2,566.4 3,425.2	236.4 309.2 480.0	139.2 358.2 341.7	170.6 245.9 330.2	44.6 53.0 62.2	2,260.4 3,532.7 4,639.3	1,079.9 1,131.5 1,447.2	1,493.2 1,476.1 1,603.4	1,329.7 1,976.9 2,368.5	6,863.6 15,935.8 20,836.0	4,782.9 7,955.8 10,079.0	22,775.9 37,561.0 47,916.0
k. Other Western Europe	753.9 1,108.0 1,401.4	78.0 120.8 165.8	47.3 111.7 141.2	76.7 112.7 150.6	15.4 24.2 24.6	971.3 1,477.4 1,883.6	204.4 317.8 387.2	536.1 504.8 554.6	1,600.5 2,223.4 2,671.2	3,083.7 4,802.5 5,661.2	1,595.9 2,863.3 3,869.3	9,531.0 14,321.0 17,894.0
Total Imports	13,410.2 17,213.0 21,431.0	5,351.5 6,099.0 8,008.0	3,033.5 6,737.0 8,170.0	1,796.8 2,480.0 3,373.0	707.3 824.0 966.0	24,299.3 33,353.0 41,948.0	8,389.2 10,730.0 12,000.0	8,170.6 7,810.0 8,660.0	10,569.5 13,476.0 16,138.0	22,995.3 40,417.0 49,004.0	12,320.9 19,611.0 24,926.0	114,704.3 142,600.0 173,700.0

Source : Direction of Trade, Annual 1958-62, 1961-65, A Supplement to International Financial Statistics.

Other Asia includes Afghanistan, Brunei, Burma, Cambodia, Ceylon, China Taiwan, Hong Kong, India, Indonesia, Irian Barat, Korea Republic, Laos, Macao, Malaya Fed, North Borneo, Pakistan, Philippines, Ryukyus, Sarwak, Singapore, Thailand, Viet Nam, Br Asia Ns, Ind Sterl Asia, Port Asia Ns, Port Poss India, Asia Ns. China and China Mainland are excluded.

TABLE 2 Consolidated Trade Matrix

(A) Trade Matrix (million dollars)

to / Exports from	A PAFTA	B ALA	C Europe	Total Exports
A. PAFTA	9,160.5 13,552.8 18,021.7	5,457.3 8,300.6 9,793.5	7,522.0 10,838.7 13,474.2	28,226.7 39,323.0 48,371.0
B. Other Asia and Latin America	5,745.3 6,505.5 7,390.5	2,992.7 2,194.9 2,505.3	4,153.9 5,083.7 5,481.8	14,910.9 17,040.0 19,000.0
C. Europe	5,684.3 7,662.3 9,853.8	4,782.3 4,956.2 5,535.4	22,227.5 40,706.8 51,157.7	41,699.0 63,739.0 79,520.0
Total Imports	24,299.3 33,353.0 41,948.0	16,559.8 18,540.0 20,660.0	45,885.7 73,504.0 90,068.0	114,704.3 142,600.0 173,700.0

(B) Distribution of Exports (%)

to / from	A PAFTA	B ALA	C Europe	Total Exports
A	32.45 34.47 37.26	19.33 21.11 20.25	26.65 27.57 27.86	100.00 100.00 100.00
B	38.53 38.17 38.90	20.07 12.88 13.19	27.86 29.84 28.85	100.00 100.00 100.00
C	13.63 12.02 12.39	11.47 7.78 6.96	53.30 63.87 64.33	100.00 100.00 100.00
Total Imports	21.18 23.39 24.15	14.44 13.00 11.89	40.00 51.55 51.85	100.00 100.00 100.00

(C) Intensity of Trade

to / from	A PAFTA	B ALA	C Europe
A	132 127 133	116 140 147	58 46 46
B	160 144 144	123 88 99	61 51 50
C	51 40 40	63 46 45	106 95 96

upper column, 1958
middle column, 1963
lower column, 1965

PAFTA : USA, Canada, Japan, Australia and New Zealand
ALA : Other Asia and Latin America
Europe : United Kingdom, EEC and Other Europe

TABLE 3 Intensity of Trade

upper column, 1958
middle column, 1963
lower column, 1965

to(j) / Exports from(i)	a U S A	b Canada	c Japan	d Australia	e N. Z.	f Pacific C.	g Other Asia	h Latin Am.	i U. K	j E E C	k Other W. E
a USA		362 363 389	158 137 140	60 96 115	34 47 72	168 172 197	125 144 102	310 239 273	45 47 55	85 88 98	64 57 78
b Canada	485 426 423		77 83 70	65 76 77	48 69 68	455 411 417	48 27 26	55 67 63	164 141 132	58 37 41	29 23 22
c Japan	200 220 230	55 51 52		129 159 189	41 131 122	215 233 255	542 427 402	101 111 104	39 29 25	30 34 34	35 34 38
d Australia	49 93 87	38 43 30	460 361 347		1,202 1,086 1,109	205 263 252	162 145 169	11 11 22	316 187 186	127 83 87	26 23 25
e New Zealand	126 142 100	35 32 30	83 102 109	260 298 238		172 206 170	16 27 27	3 5 9	600 478 515	100 98 95	11 6 8
f Pacific Countries	103 102 110	233 221 227	137 117 113	66 94 110	96 122 146	213 214 233	144 151 155	212 164 180	88 74 75	74 68 73	49 43 43
g Other Asia	116 117 132	24 33 33	291 245 256	206 97 100	86 94 97	198 211 235	538 233 239	18 22 22	145 112 100	70 53 56	24 25 24
h Latin America	353 287 269	28 74 72	70 81 84	3 7 5	2 20 5	337 301 295	6 10 9	130 154 212	84 77 65	102 118 123	50 46 54
i United Kingdom	69 64 78	112 90 84	21 23 21	409 293 270	565 428 415	180 146 160	184 130 122	64 61 62		89 111 112	173 159 160
j E E C	54 47 49	19 16 18	20 17 13	41 31 30	28 20 19	65 56 59	74 38 41	87 66 64	54 46 45	184 205 224	193 149 145
k Other W. Europe	61 57 56	16 17 18	17 15 15	46 40 38	24 26 22	70 66 67	35 30 31	79 63 62	165 145 141	208 172 171	162 150 157

TABLE 4 Areal Distribution of Exports (per cent)

upper column, 1958
middle column, 1963
lower column, 1965

to (j) / Exports form (i)	a USA	b Canada	c Japan	d Australia	e N. Z.	f Pacific C.	g Other Asia	h Latin Am.	i U. K	j EEC	k Other W.E.	l Total Ex.
a. USA		19.14 17.66 20.45	4.71 7.34 7.52	1.06 1.90 2.55	0.24 0.31 0.46	25.16 27.21 30.98	7.73 10.87 7.17	22.75 13.49 13.69	4.68 5.01 5.81	13.56 17.15 18.15	6.76 7.67 10.74	100.00 100.00 100.00
b. Canada	59.45 53.74 54.74		2.14 4.08 3.44	1.07 1.39 1.56	0.31 0.42 0.40	62.98 59.63 60.14	2.74 1.86 1.67	3.74 3.49 2.92	15.85 13.89 12.85	8.62 6.66 6.89	2.80 2.87 2.75	100.00 100.00 100.00
c. Japan	24.07 27.92 29.78	2.65 2.29 2.54		2.18 2.91 3.78	0.26 0.80 0.72	29.16 33.92 36.82	30.49 29.67 25.92	6.73 5.78 4.79	3.66 2.86 2.43	4.31 6.08 5.73	3.39 4.23 4.82	100.00 100.00 100.00
d. Australia	5.81 11.48 10.99	1.79 1.88 1.40	12.33 17.34 16.63		7.57 6.41 6.32	27.50 37.11 35.34	9.01 9.78 10.61	0.73 0.56 0.98	29.55 17.98 17.62	18.19 14.50 14.44	2.46 2.70 3.11	100.00 100.00 100.00
e. New Zealand	14.87 17.24 12.36	1.63 1.38 1.37	2.20 4.86 5.13	4.11 5.22 4.65		22.81 28.70 23.52	0.90 1.80 1.67	0.17 0.26 0.41	55.63 45.45 48.11	14.15 16.87 15.50	1.06 0.67 1.02	100.00 100.00 100.00
f. Pacific Count.	13.87 14.35 15.80	12.56 10.99 12.14	4.16 6.41 6.00	1.19 1.90 2.48	0.68 0.82 0.85	32.45 34.47 37.26	9.06 11.63 11.07	15.84 9.47 9.17	9.32 8.10 8.07	12.02 13.61 13.71	5.31 5.85 6.08	100.00 100.00 100.00
g. Other Asia	14.40 15.13 17.37	1.17 1.50 1.63	8.11 12.38 12.85	3.42 1.80 2.06	0.57 0.58 0.85	27.67 31.39 34.49	31.18 16.53 15.61	1.80 1.18 1.02	14.17 11.37 9.85	10.39 9.72 9.63	2.35 3.11 3.12	100.00 100.00 100.00
h. Latin America	44.07 36.40 34.78	1.42 3.32 3.48	1.98 4.01 4.15	0.05 0.12 0.10	0.01 0.12 0.03	47.53 43.97 42.54	0.34 0.70 0.56	9.04 8.06 9.77	8.26 7.68 6.33	15.40 21.23 20.81	4.98 5.74 6.90	100.00 100.00 100.00
i. United Kingdom	8.82 8.57 10.61	5.77 4.24 4.25	0.60 1.20 1.08	7.08 5.62 5.78	3.84 2.74 2.57	26.11 22.37 24.30	11.09 9.52 8.26	4.55 3.35 2.99		13.79 21.08 20.02	17.85 20.66 21.36	100.00 100.00 100.00
j. EEC	7.33 6.83 7.15	1.04 0.82 1.00	0.61 0.95 0.71	0.75 0.65 0.69	0.20 0.14 0.13	9.92 9.41 9.68	4.74 3.01 3.02	6.56 3.93 3.35	5.84 5.26 4.94	30.14 42.43 43.48	21.00 21.18 21.03	100.00 100.00 100.00
k. Other W. Europe	7.91 7.74 7.83	0.82 0.84 0.93	0.50 0.78 0.79	0.80 0.79 0.84	0.16 0.17 0.14	10.19 10.32 10.53	2.14 2.22 2.16	5.62 3.52 3.10	16.79 15.53 14.93	32.35 33.53 31.64	16.74 19.99 21.62	100.00 100.00 100.00
l. Total Imports	11.69 12.07 12.34	4.67 4.28 4.61	2.64 4.72 4.70	1.57 1.74 1.94	0.62 0.58 0.56	21.18 23.39 24.15	7.31 7.52 6.91	7.12 5.48 4.99	9.21 9.45 9.29	20.05 28.34 28.21	10.74 13.75 14.35	100.00 100.00 100.00

TABLE 5 Importance of Each Country's Exports relative to the Total Exports of the Five Pacific Countries (%)

upper column, 1958
middle column, 1963
lower column, 1965

to / Exports from	a U S A	b Canada	c Japan	d Australia	e N. Z	f Pacific C.	g Other Asia	h Latin Am.	i U. K.	j E E C	k Other W.E.	Total Exports
a. U S A		37.408 30.479 31.086	9.211 12.667 11.436	2.075 3.288 3.877	0.473 0.530 0.700	49.168 46.963 47.098	15.108 18.756 14.925	44.465 23.288 20.812	9.153 8.654 8.835	26.511 29.601 27.599	13.222 13.239 12.175	195.451 172.606 152.039
b. Canada	32.980 26.882 25.923		1.188 2.039 1.628	0.596 0.696 0.737	0.174 0.213 0.191	34.937 29.829 28.478	1.517 0.930 0.792	2.073 1.744 1.382	8.794 6.945 6.084	4.781 3.334 3.264	1.553 1.437 1.303	55.473 50.019 47.354
c. Japan	7.560 11.233 13.967	0.833 0.921 1.191		0.683 1.170 1.772	0.081 0.323 0.340	9.157 13.647 17.269	9.574 11.937 12.155	2.115 2.324 2.246	1.148 1.150 1.138	1.354 2.448 2.686	1.064 1.700 2.258	31.405 40.235 46.899
d. Australia	1.056 2.363 1.817	0.325 0.387 0.231	2.240 3.566 2.748		1.374 1.319 1.045	4.995 7.635 5.840	1.636 2.013 1.753	0.132 0.116 0.162	5.367 3.699 2.911	3.304 2.982 2.387	0.446 0.555 0.514	18.162 20.571 16.525
e. New Zealand	1.136 1.158 0.691	0.124 0.093 0.077	0.168 0.326 0.287	0.314 0.350 0.260		1.743 1.927 1.314	0.069 0.121 0.093	0.013 0.018 0.023	4.252 3.052 2.688	1.082 1.133 0.866	0.081 0.045 0.057	7.644 6.714 5.588
f. Pacific Count.	42.731 41.635 42.397	38.691 31.880 32.584	12.807 18.598 16.098	3.669 5.504 6.645	2.101 2.384 2.275	100.000 100.000 100.000	27.913 33.757 29.718	48.798 27.490 24.625	28.715 23.500 21.657	37.032 39.498 36.802	16.367 16.976 16.308	308.135 290.147 268.404
g. Other Asia	10.622 8.761 8.287	0.862 0.870 0.780	5.982 7.172 6.133	2.522 1.043 0.982	0.426 0.338 0.277	20.403 18.184 16.459	22.990 9.573 7.450	1.321 0.683 0.488	10.447 6.587 4.700	7.663 5.628 4.593	1.736 1.799 1.487	73.751 57.922 47.720
h. Latin America	39.233 24.683 20.073	1.263 2.253 2.008	1.761 2.720 2.394	0.044 0.083 0.055	0.012 0.078 0.020	42.312 29.817 24.550	0.306 0.474 0.325	8.047 5.465 5.639	7.350 5.209 3.650	13.709 14.399 12.008	4.438 3.890 3.980	89.022 67.809 57.708

TABLE 6

Trade in 1965 relative to 1958

	Exports	Imports
World Trade	151.4	
PAFTA Trade	196.7	
U.S.A.	188.5	195.2
Canada	160.4	165.7
Japan	371.0	247.3
Australia	230.0	356.3
New Zealand	148.3	213.0
PAFTA . ALA	179.5	128.6
PAFTA . Europe	179.1	174.3
PAFTA . World	171.4	172.6
EEC . EEC	303.6	
Europe . Europe	230.2	

PAFTA	Trade : By Commodity
N_1	235.5
N_2	160.6
N_3	183.5
N_4	163.8
L_1	186.3
L_2	252.4
C_1	232.4
C_2	288.9
F	180.7
R	173.4
L	199.6
C	263.8

TABLE 7 Degree of Horizontal Trade in EEC Countries

upper column = 1956-58 averages
middle column = 1960
lower column = 1965

(a) Trade between each two countries in EEC

	$C_1 \cdot C_2$	$C_1 \cdot C_3$	$C_1 \cdot C_4$	$C_1 \cdot C_5$	$C_2 \cdot C_3$	$C_2 \cdot C_4$	$C_2 \cdot C_5$	$C_3 \cdot C_4$	$C_3 \cdot C_5$	$C_4 \cdot C_5$
$D:N_1$	2 2 3	8 59 4	81 59 8	55 84 3	21 22 48	3 9 16	27 46 18	100 33 25	50 43 40	67 99 72
N_2	32 23 19	8 10 22	56 38 23	6 7 5	42 79 63	61 62 89	24 18 20	58 72 97	22 18 13	27 33 48
N_3	29 15 39	49 73 62	28 32 35	29 28 27	16 16 21	35 27 47	91 90 50	11 12 8	24 41 24	94 96 96
N_4	58 38 70	16 19 21	28 29 39	90 95 80	20 27 34	78 59 53	18 17 64	84 41 18	65 39 14	70 66 65
L_1	55 30 46	73 35 26	97 72 53	63 98 97	76 72 47	58 43 79	33 25 76	24 22 33	31 33 17	59 63 58
L_2	30 39 38	11 23 99	15 25 45	16 28 41	51 56 65	45 47 94	78 72 80	69 88 67	81 79 47	96 91 64
C_1	73 77 90	18 35 67	65 44 50	45 54 64	62 34 67	51 62 54	94 97 90	12 11 44	36 50 98	19 29 37
C_2	20 52 54	34 59 87	9 13 50	14 29 41	64 99 52	37 26 65	81 72 73	36 39 62	56 69 71	50 55 53
$\bar{D}:T$	47 49 57	28 37 56	43 37 47	34 49 53	50 59 53	53 49 65	55 54 63	32 31 49	36 34 47	50 55 54
N	46 29 40	15 24 25	60 32 33	35 39 30	27 43 45	60 49 60	33 31 36	43 44 48	26 16 15	58 60 62
L	48 32 44	56 32 44	69 59 51	47 77 81	70 68 52	55 44 83	42 35 77	35 35 42	40 41 23	64 67 59
C	48 67 70	28 49 80	38 31 50	29 42 51	63 69 58	47 51 58	89 86 81	22 21 55	48 60 81	34 42 46
L + C	48 58 62	37 43 65	46 38 50	33 51 61	65 69 56	49 49 66	76 73 79	27 26 50	45 53 61	47 53 52

(b) Trade of each country with EEC as a whole

	$C_1 \cdot E$	$C_2 \cdot E$	$C_3 \cdot E$	$C_4 \cdot E$	$C_5 \cdot E$
$D:N_1$	21 33 4	13 7 17	19 48 62	39 68 73	98 96 90
N_2	12 12 14	95 82 71	32 45 79	46 59 96	15 15 16
N_3	32 42 36	35 27 49	50 27 48	95 93 95	59 42 43
N_4	48 41 64	77 71 96	21 28 70	59 50 47	72 74 82
L_1	92 53 52	62 44 76	60 40 30	85 89 74	57 67 71
L_2	18 29 51	76 74 56	31 40 82	46 52 84	46 59 54
C_1	82 80 96	95 86 86	28 32 67	41 42 47	41 51 59
C_2	17 36 55	52 94 73	68 81 83	55 52 76	31 42 50
$\bar{D}:T$	46 48 58	72 74 74	43 47 66	59 59 69	43 49 54
N	31 30 34	69 63 66	32 36 71	63 62 75	45 41 43
L	68 46 52	66 52 71	53 40 43	77 82 76	55 65 67
C	48 60 72	77 89 79	51 58 77	47 46 62	36 47 54
L + C	54 56 66	74 80 77	51 52 64	57 58 67	42 53 57

Note : C_1=West Germany, C_2=France, C_3=Italy, C_4=Belgium and Luxemburg, C_5=Netherland, E=EEC
Reproduced from kiyoshi Kojima, "The Pattern of International Trade among Advanced Countries",
Hitotsubashi Journal of Economics, June 1964, PP.25-26, for 1956-58 and 1960.

TABLE 8 Degree of Horizontal Trade in Pacific Countries

upper column, 1958
lower column, 1965

(a) Trade between each two countries

(b) Trade of each country with PAFTA

	a·b	d·e	a·c	b·c	a·d	b·d	b·e	a·e	c·e	c·d	a·f	b·f	c·f	d·f	e·f
D : N_1	46.7 17.5	0.4 1.1	0.2 0.2	0.04 0	0 0	0 0	0 0	0 0	0 0	0 0	41.3 50.2	20.5 82.5	0.1 0.1	0.2 1.2	0.4 1.1
N_2	58.6 68.2	50.6 66.3	17.6 74.3	34.7 62.9	12.9 17.9	11.1 13.1	11.7 29.0	2.5 10.7	94.3 4.5	43.9 19.5	44.2 62.4	64.2 76.6	18.9 58.9	28.6 19.9	14.2 24.6
N_3	45.2 57.8	74.6 98.7	7.5 5.8	8.9 3.1	82.5 28.0	38.2 57.1	58.9 28.3	5.3 6.8	5.9 0.9	0.3 1.1	97.2 88.3	44.4 53.9	4.8 3.8	20.5 12.8	17.3 12.1
N_4	48.3 46.0	0.7 1.6	0.1 1.4	0 0.2	96.2 84.0	0 6.5	0 0	0 0	0 84.3	0.9 3.2	66.8 84.1	47.1 41.3	0.1 1.8	35.6 23.7	7.8 4.9
L_1	34.1 62.7	64.7 97.3	2.5 7.6	0.3 2.2	24.5 7.5	3.0 1.3	0 0	4.1 0.2	0.2 0.3	2.2 4.4	24.2 39.7	39.9 71.1	2.2 6.6	21.7 11.3	33.9 32.9
L_2	8.9 15.8	1.0 2.5	33.5 24.9	5.6 0.4	2.9 0.2	0 23.8	0 0	0 0	0 0	0 0.1	36.1 59.6	9.5 16.3	28.8 21.2	17.0 43.7	0.3 1.8
C_1	76.7 63.7	18.3 12.2	68.7 32.7	80.3 94.1	95.8 35.5	1.4 9.9	6.8 0	48.7 40.0	39.9 15.5	29.8 19.5	84.2 57.4	75.4 63.1	75.2 35.0	80.7 53.2	24.8 15.8
C_2	18.4 31.2	2.0 3.6	31.9 73.6	18.3 14.2	2.1 0.5	1.4 1.7	0 0	0.3 0.2	0 0	7.4 0.8	19.0 39.6	19.9 33.2	39.5 60.8	17.3 9.5	1.0 1.3
$\bar{D}$: T	43.6 47.2	26.3 30.5	18.2 30.2	7.8 21.9	48.2 16.1	10.2 13.1	12.6 9.0	5.9 8.4	15.4 6.5	2.6 5.2	53.3 54.8	44.3 50.3	17.1 24.1	30.1 20.4	15.4 13.8
F	57.1 58.4	21.2 40.7	7.7 28.2	3.6 9.5	12.9 17.4	11.4 13.0	11.7 29.0	2.5 10.7	94.3 4.5	10.8 11.3	43.6 58.5	55.5 78.1	6.9 22.5	17.5 16.9	12.1 21.8
R	47.2 50.7	27.8 56.0	5.4 4.1	4.8 1.3	87.2 42.4	29.0 39.5	49.3 24.3	4.7 6.2	5.0 4.7	0.4 1.8	84.4 86.2	46.1 46.4	3.7 3.1	23.9 16.2	14.2 11.1
N	50.5 53.1	24.9 47.2	6.2 14.6	3.8 5.1	69.3 29.7	22.4 26.2	22.0 25.9	3.3 8.0	18.8 4.7	1.5 3.5	70.3 76.0	49.5 56.8	4.8 10.3	22.5 16.4	13.1 15.7
L	29.0 50.4	58.9 55.1	8.3 12.0	1.4 1.8	13.1 4.9	2.8 5.1	0 0	1.9 0.1	0.2 0.3	2.1 3.9	26.7 44.9	33.8 56.9	7.3 10.0	21.0 19.5	27.7 22.1
C	22.4 42.9	13.6 8.6	21.5 54.2	43.2 69.1	36.7 9.0	1.4 4.9	2.2 0	18.6 10.9	30.8 12.3	23.0 11.2	52.0 46.3	44.9 44.3	54.1 48.0	47.7 25.2	14.8 8.6
L+C	39.6 44.9	27.5 25.3	26.1 43.5	12.9 38.0	33.7 8.2	1.9 4.9	2.0 0	14.4 8.8	8.5 7.8	5.9 7.8	42.9 45.9	41.2 47.7	27.3 32.2	39.1 23.5	18.9 12.6

a : USA, b : Canada, c : Japan, d : Australia, e : New Zealand, f : PAFTA

TABLE 9 Static Effects of the Formation of PAFTA

(A) Value of Increase (million dollars) base year - 1965

		a USA	b Canada	c Japan	d Australia	e N. Z	Pacific Countries
a. USA	X		1,404.6	404.4	426.3	66.4	2,301.7
	M		791.5	1,457.5	23.6	10.5	2,283.2
	X - M		613.1	-1,053.1	402.7	55.9	18.5
b. Canada	X	791.5		17.2	39.5	7.2	855.4
	M	1,404.6		75.9	0.2	0.1	1,480.8
	X - M	-613.1		-58.7	39.3	7.1	-625.4
c. Japan	X	1,457.5	75.9		176.7	33.0	1,743.1
	M	404.4	17.2		7.6	3.5	430.7
	X - M	1,053.1	58.7		169.1	29.5	1,312.4
d. Australia	X	23.6	0.2	7.6		33.2	64.5
	M	426.3	39.5	216.2		8.1	650.6
	X - M	-402.7	-39.3	-208.6		25.1	-586.1
e. N. Z	X	10.5	0.1	3.4	8.1		22.1
	M	66.4	7.2	33.0	33.2		139.7
	X - M	-55.9	-7.1	-29.6	-25.1		-117.6
Pacific Countries	X						4,986.8
	X						18,021.7

(B) Rate of Increase (%) in trade due to the Elimination of Tariffs.

		a USA	b Canada	c Japan	d Australia	e N. Z	Pacific Countries
a. USA	X / X		26.06	19.85	61.48	53.13	27.92
	M/M		17.03	58.59	7.24	8.56	30.10
b. Canada	X / X	17.03		5.86	29.79	20.95	16.74
	M/M	26.06		35.43	0.44	0.94	26.17
c. Japan	X / X	58.59	35.43		50.25	54.17	55.97
	M/M	19.85	5.86		1.37	7.02	14.69
d. Australia	X/ X	7.24	0.44	1.37		17.13	5.79
	M/M	61.48	29.79	61.48		18.95	53.32
e. N.Z.	X/ X	8.56	0.94	6.85	18.95		9.76
	M/M	53.14	20.95	54.17	17.13		33.77
Pacific Countries	X / X						27.67

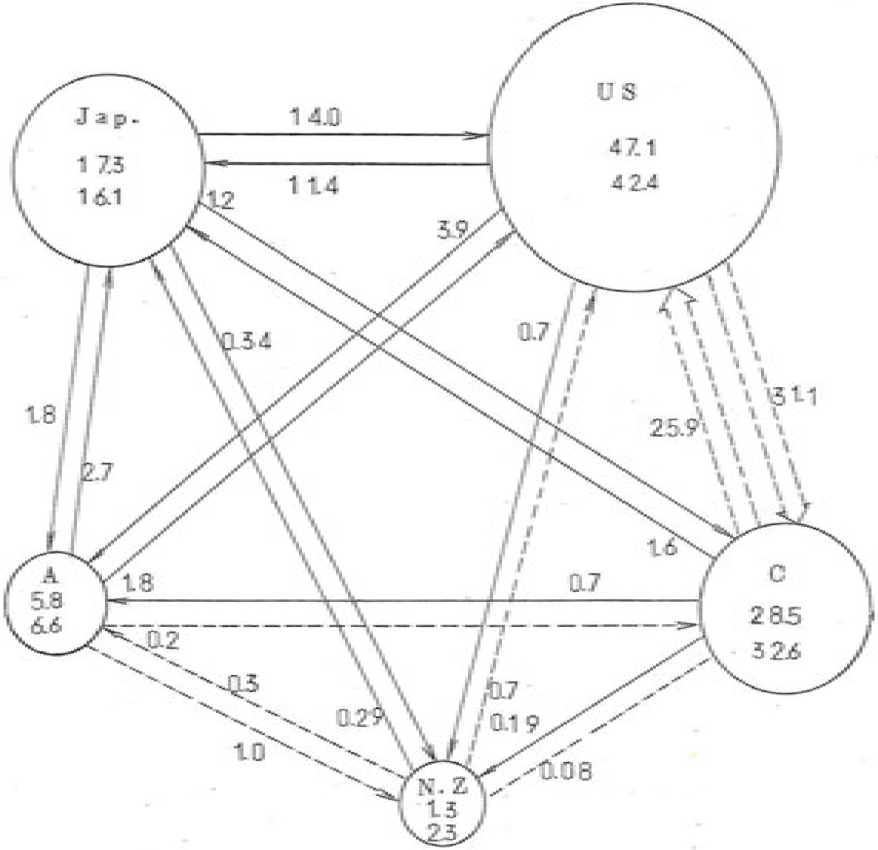
TABLE 10 Static Effects of PAFTA : By Commodity Groups

		Food		Raw Materials		Light Manufactures		Heavy M. and Chemicals	
		ΔX or ΔM	ΔX / X or Δ M/M	ΔX or Δ M	ΔX / X or Δ M/M	ΔX or Δ M	Δ X/X or Δ M/M	ΔX or Δ M	ΔX / X or Δ M/M
a. U S A	Ex.	34.4$m	3.49%	27.9$m	1.88%	432.0$m	35.22%	1,807.4$m	39.73%
	Im.	43.4	5.75	38.9	2.55	933.5	45.40	1,267.4	38.98
	Bal.	-9.0		-1.10		-501.5		540.4	
b. Canada	Ex.	18.6	3.33	27.7	1.90	177.3	18.52	631.8	29.60
	Im.	6.4	1.33	12.9	1.92	332.0	30.79	1,129.4	32.97
	Bal.	12.2		14.8		-154.7		-497.6	
c. Japan	Ex.	29.9	25.07	1.6	3.96	888.2	61.68	823.3	54.40
	Im.	23.5	3.25	8.8	0.65	79.8	11.54	318.6	44.96
	Bal.	6.4		-7.2		808.4		504.7	
d. Australia	Ex.	6.7	2.24	11.8	1.99	8.8	14.56	37.2	22.89
	Im.	11.3	22.77	9.2	9.72	138.1	41.31	491.9	66.35
	Bal.	-4.6		2.6		-129.3		-454.7	
e. New Zealand	Ex.	1.2	1.59	4.9	4.45	4.3	22.17	11.7	56.95
	Im.	6.3	19.94	4.1	12.65	25.2	26.18	104.2	41.03
	Bal.	-5.1		0.8		-20.9		-92.5	
Pacific Countries	Ex.	90.8	4.45	73.9	2.01	1,510.6	40.79	3,311.4	39.51
Total Exports of Pacific Countries in 1965.		2,040.3		3,684.6		3,703.5		8,381.1	

TABLE 11 Comparison of Static Effects of PAFTA and the Kennedy Round

		(A) PAFTA		(B) Kennedy Round	
		Value of Increase (million $)	Rate of Increase relative to total trade (%)	Value of Increase (million $)	Rate of Increase relative to total trade (%)
a USA	Ex.	2,301.7	8.40	1,483.0	5.41
	Im.	2,283.2	10.65	1,711.8	7.99
	Bal.	18.5		-228.8	
b Canada	Ex.	855.4	10.02	369.8	4.33
	Im.	1,480.8	18.49	651.1	8.13
	Bal.	-625.4		-281.4	
c Japan	Ex.	1,743.1	20.62	741.0	8.77
	Im.	430.7	5.27	278.2	3.41
	Bal.	1,312.4		462.8	
d Australia	Ex.	64.5	2.17	39.6	1.33
	Im.	650.6	19.29	504.7	14.96
	Bal.	-586.1		-465.1	
e New Zealand	Ex.	22.1	2.19	15.4	1.53
	Im.	139.7	14.46	102.6	10.62
	Bal.	-117.6		-87.2	
Pacific Countries	Ex.	4,986.8	10.31	2,648.8	5.48
	Im.	4,985.0	11.88	3,248.4	7.74
	Bal.	0		-599.6	
1965: Total Exports		48,371.0			
Total Imports		41,948.0			
Balance		6,423.0			

Figure 1 Share in the total intra-areal trade of five Pacific countries: Total trade of each country in 1965.



1) Figures in the circle show the share of each country's exports (upper figure) to and imports (lower figure) from the Pacific countries.
2) Figures along the line show the share of each bilateral trade.
3) Solid line and circle show the increase of importance while dotted ones the decrease of importance during the period of 1958 - 1965.

Figure 2 Share in the total intra-areal trade of five Pacific countries : Heavy manufactures and chemicals (C-goods)
Total share 46.51%

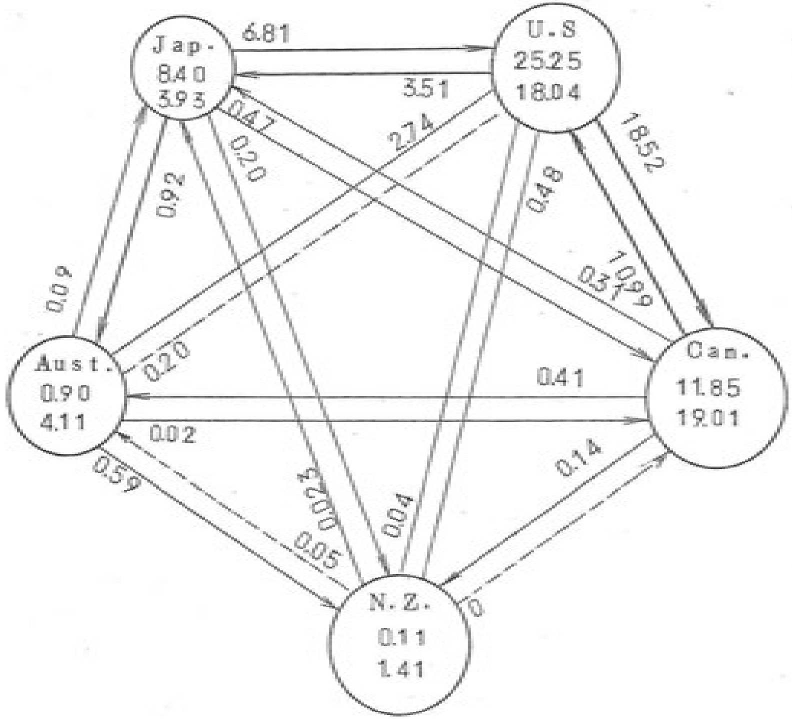


Figure 3 Share in the total intra-areal trade of five Pacific countries : Light manufactures (L-goods)
Total share 20.55 %

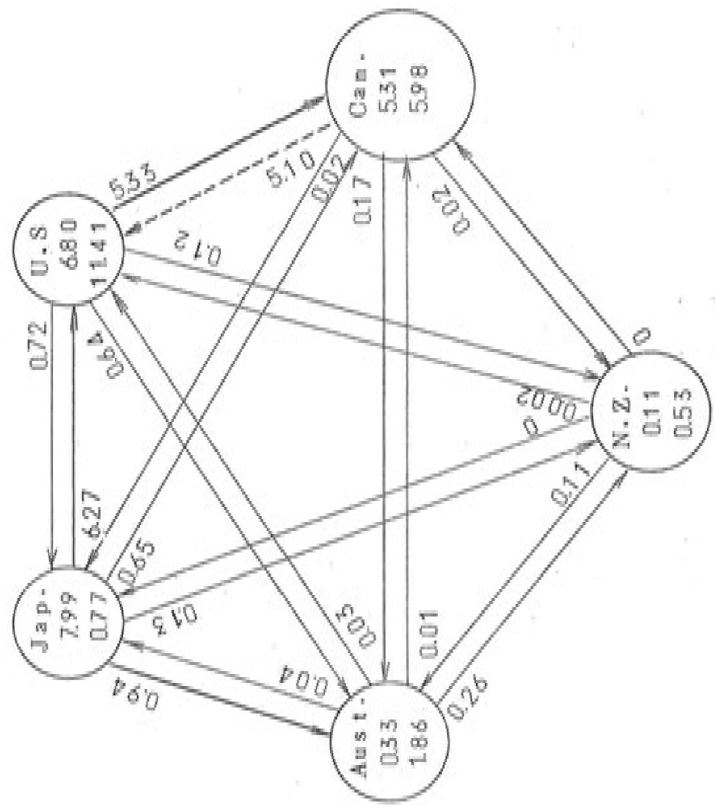


Figure 4 Share in the total intra-areal trade of five Pacific countries : Raw materials (R-goods)

Total share 20.45%

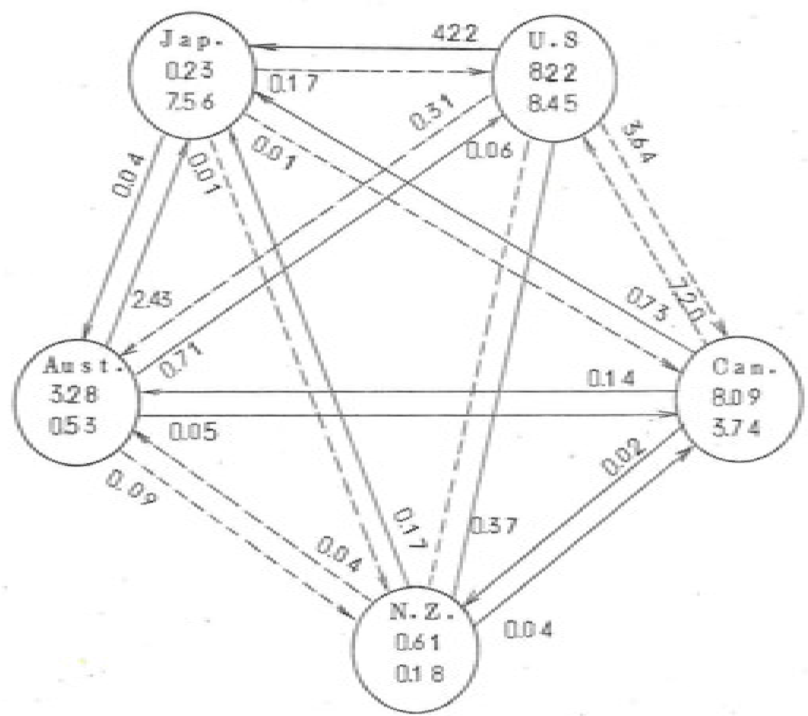
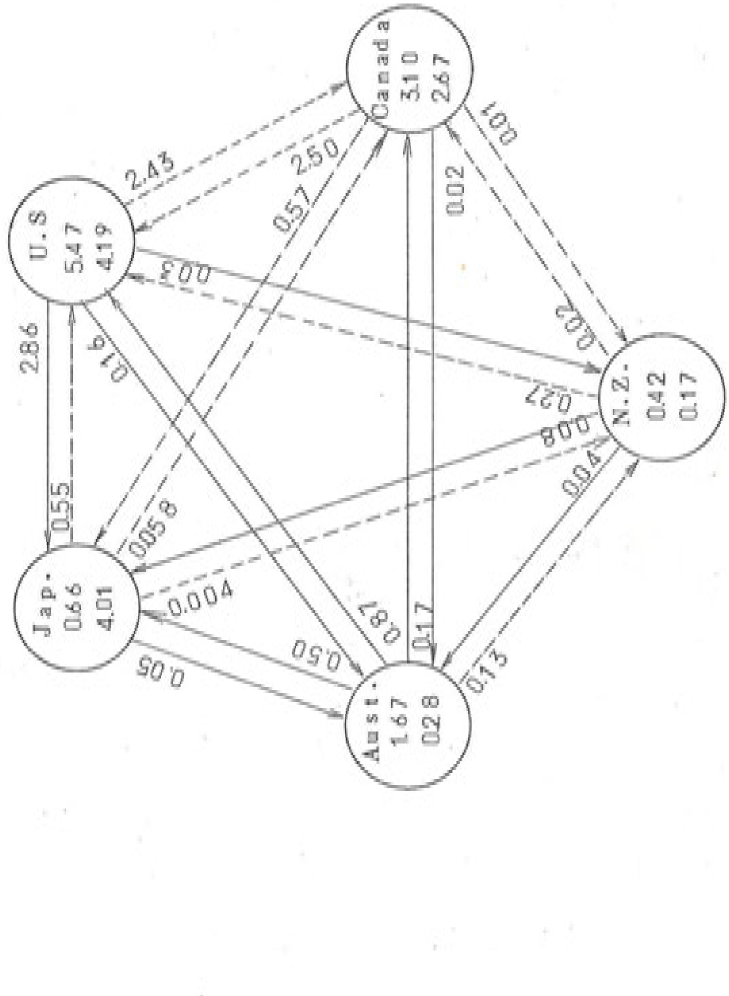


Figure 5 Share in the total intra-areal trade of five Pacific countries : Food (F-goods)
Total share 11.32%



Chapter 6 PACIFIC ECONOMIC INTEGRATION: AN AUSTRALIAN VIEW

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I Introduction

Last year must rank among the most significant in the history of Australia's international commerce. Japan became Australia's largest export market - the first occasion that any country surpassed the United Kingdom in its annual purchases of Australian produce. Less noticed, but no less significantly, the United States replaced Britain as Australia's major supplier of imports - again the first occasion that any country's annual sales to Australia have been larger than the United Kingdom's.

These developments underline Australia's already profound and growing interest in Pacific area trade. But has the conjuncture of both major shifts in the geographic structure of Australian trade any wider significance? And how might it shape the future evolution of Australia's commercial policy?

Answers to these questions first require brief consideration of the factors which have caused largescale transformation in Australia's economic structure and trade specialisation over the last decade and a half. Second, an assessment is made of the criteria for effective integration amongst advanced Pacific countries. Third, estimates of the impact of mutual tariff elimination amongst Pacific countries upon Australian trade, international payments, industrial production, and employment are presented. Fourth, the dynamic effects upon the Australian economy are stressed. Finally, an attempt is made to guage the acceptability to Australia of various policies designed to promote Pacific economic integration.

II Transformation in Australia's Trade Specialisation

The essential features of Australia's commodity specialisation in world trade are well known. But the pattern of export specialisation in raw materials and foodstuffs and import specialisation in manufactures has been substantially modified in recent years. The growth of Australia's export specialisation in minerals and metals has been accompanied by the strengthening of export specialisation in manufactures, whilst producer materials and equipment increasingly dominate import specialisation. Australia's postwar economic growth was characterised by the large scale immigration of labour and capital from the United Kingdom, Europe, and North America, and factor migration was stimulated by trade restraints which encouraged the expansion of the import-competing manufacturing sector. Hence, the effect of factor migration and forced industrialisation superimposed itself upon the effect of basic resource endowments in the development of Australia's present structure of production and trade.

Although made-to-measure protectionism encouraged the expansion of some highly inefficient industrial activity, it also resulted in the establishment of a relatively efficient industrial base centred on steel, metals, motor vehicles, and engineering. Throughout the interwar period and most of the postwar period, the employment-creating and infant-economy arguments seemed powerful justifications for Australian protectionism. With the transformation of Australia's trade and economic structure there has recently been widespread questioning of the extent and structure of tariff protection, not least by the Australian Tariff Board itself.

The most remarkable developments in the geographic structure of trade have undoubtedly been in Japanese - Australian trade relations. Between 1950 and 1967, Japan's share in Australian exports rose from 4 percent to 19 percent, whilst the United Kingdom's share fell from 39 to 13 percent. Throughout the same period, Japan's share in Australian imports rose from 1 percent to 10 percent whilst the United Kingdom's share fell from 52 percent to 24 percent.

These shifts in the geographic structure of Australian trade resulted from two broad sets of factors: the underlying complementarity between Japanese and Australian economic resource endowments, and factors affecting the geographical, political, and historical closeness of the two economies.

In the first place, the increased importance of the Japanese market to Australia derived from Japan's very high rates of economic growth, and her vastly increased share in world trade. The high degree of complementarity between the Japanese and Australian economies ensured that Japan's overall trade growth stimulated proportionately larger purchases from and sales to Australia. In the earlier phases of post-war Japanese growth, increased import demand was heavily concentrated on textile raw materials and provided new outlets for exports of Australian wool. In later phases, accelerated heavy industrialisation and new patterns of consumer demand associated with higher income levels strengthened Japanese import demand for fuel and minerals, such as coal, iron ore, copper, bauxite, and alumina, and foodstuffs such as wheat, meat, and dairy products. On the other hand, Japan specialised in the export of manufactured goods for which Australia's import demand has always been relatively strong. In the past, the degree of complementarity between the structure of Japanese exports and Australian imports within these broad commodity categories was not so strong as the degree of complementarity between the structure of Australian exports and Japanese imports - one factor which helps account for persistent bilateral imbalances in Japanese - Australian trade. But the growing share of capital equipment and machinery in Japanese exports, and their predominance in Australian imports, is likely to strengthen complementarity in that trade flow.

In the second place, geographical proximity always favoured Japanese - Australian trade. Of course, some commodities, especially manufactured goods, can be delivered to distant markets at relatively small cost so that the location of foreign markets does not much affect the geographic distribution of their export - another factor which accounts for bilateral imbalances in Japanese - Australian trade. On the other hand, low value to weight bulk commodities, like fuels and mineral ores, are generally expensive to transport and nearby sources of supply offer distinct cost advantages to international buyers. These considerations prompted Japan's large scale participation in the development of Australia's huge deposits of high quality and accessible coal, iron ore, bauxite, and copper. Australia promises, for Japan, to be the most adequate and stable source of supply of these materials for many years, especially because of increased political uncertainties in mainland China. Japan has already contracted to buy large quantities of iron ore, coal, bauxite, and alumina in the next two decades. By the early 'seventies Australia will be supplying almost 40 percent of Japan's imported iron ore, compared with the 10 percent she is currently supplying, and well over 40 percent of Japan's imported coal, compared with the 27 percent she is already supplying. Indeed, Japanese demands have played a major role in the recent development of Australia's strong advantage in the export of mineral products. By the middle 'seventies they will have effected a complete transformation in Australia's whole specialisation in the world economy and far-reaching changes in the whole fabric of Australia's political economy when minerals and associated manufactures replace wool as Australia's chief export earner.

Institutional factors and trade policy have not always favoured a large trade between Japan and Australia. As is well known, they positively inhibited it. Significantly, it was the breakdown of special institutional and policy biases against trade between the two countries that permitted its remarkable expansion in recent years. Australia's earlier reluctance to foster freer trading relations with Japan stemmed from strong economic, cultural, and political ties with the United Kingdom, fears of 'cheap labour' competition, and the hangover of war, and her trade policy discriminated severely against imports from Japan until 1957. The conclusion of a trade agreement between the two countries in that year was the major watershed in Japanese - Australian trading relations after the war. Under the agreement, Australia accorded Japan most-favoured-nation treatment, which involved substantial reductions in tariffs on textiles and other consumer goods and nondiscriminatory treatment under import licensing arrangements. Japan allowed freer access to her markets for Australian agricultural exports and she undertook not to impose a duty on the import of wool. In 1963, the agreement was renewed and extended. Australia relinquished her right under Article 35 of GATT to discriminate specifically against Japanese imports. In return, Japan made new concessions in her import policy towards Australian wool, foodstuffs, and motor vehicles.

It is impossible to over-stress the role these trade agreements played in establishing freer and fuller economic relations between Japan and Australia. A complete transformation of each country's interest in the other has been effected under their aegis. Their direct impact on trade growth was reinforced by a combination indirect dynamic effects on trade and investment flows.

One obstacle to the development of Japanese - Australian trading relations was the quite general difficulty encountered in all trading with foreign countries where business rapport must be established carefully and slowly. Perhaps in some ways this factor posed a greater problem for Australians who were not used in the past to dealing with nations very different in language and customs from their own. But in other ways it posed a far greater problem for the Japanese. The nature of the merchandise which Japanese exporters were newly trying to sell in Australian markets demanded more direct contact with Australian businessmen and knowledge of Australian industrial conditions. In this connection, the establishment of the Japan - Australian Business Co-operation Committee in 1963 proved valuable, not only to Japanese businessmen in their understanding of the character and potential of the Australian economy, but also to Australian businessmen in their understanding of the mutual benefits to be drived from trade with Japan, and their vision of the international economy, both of which have been considerably enhanced by the dialogue with their Japanese counterparts. To those who remember the chilly reception which Australian manufacturing interests gave the first trade agreement in 1957, this development must rank among the most satisfying in the history of postwar Japanese - Australian relations.

The changes in the relative magnitude of Japanese - Australian trade, and their explanation, only begin to tell the full story. For growth in trade between Japan and Australia has had significance beyond anything its mere proportions suggest. It was one factor in the complete re-orientation of Australia's economic and political relations away from Britain and Europe towards Asia and the Pacific - a realignment of consequence not only to Australia's economy but also to her whole international outlook. It contributed to fundamental changes in Australian attitudes to international and commercial affairs.

The developments in United States - Australian trade hardly seem less noteworthy than those in Japanese - Australian trade. Between 1950 and 1967, the United States' share in Australian exports rose from 8 percent to 12 percent. Throughout the same period, the share in Australian imports rose from 10 to 26 percent. But these developments have not had the same impact on the public mind as their Japanese counterparts. Other political and strategic questions have dominated United States - Australian relations.

On the other hand, American investment in the Australian economy has been the subject of considerable public discussion. And the role of American investment in Australia's postwar industrial transformation is intimately bound up with these changes in the geographic structure of Australian trade. There has been relatively largescale American investment in new Australian activity throughout the whole postwar period. Firms in new industries have a very high propensity to import equipment and supplies which are commonly not available domestically. American private investors, through their firms, subsidiaries and associates, tended to buy equipment and producer materials from their home country (if not their home firm), thus boosting the proportion of imports originating in the United States, over two-thirds of which consist of machinery, equipment, and producer materials.

Growth in the share of Australian exports destined for the United States has been far less impressive. Significantly, this results from the persistence and effectiveness of protectionist pressures in the United States against Australia's principal exports, wool, minerals, and foodstuffs, all of which are subject to high tariff duties or import quota restrictions. For obvious reasons, Australia herself has not been capable of negotiating any significant trade concessions from the United States.

These shifts in the geographic structure of Australia's trade alone evidence her huge stake in Pacific area trade. Her trade with New Zealand re-inforces this evidence. Already about 40 percent of Australia's exports are taken by Japan, the United States, New Zealand, and Canada, whilst a similar proportion of imports originates in these four countries. Australia would appear to have a particularly strong interest in closer Pacific economic co-operation.

Apart from these developments in trade with the Pacific area, the most significant change in the geographic structure of Australia's trade was growth in export trade with Asia. Between 1950 and 1967, Australian exports destined for Asia rose from 11 to 18 percent, partly because of large wheat sales to China, and partly because of increased exports of manufactured goods to the region. The propinquity of Asian markets and certain similarities in the structure of Australian and Asian demand for industrial goods have facilitated this new trade. Since the early sixties, trade policy has been directed towards promoting exports of manufactures. Trade in manufactures with Asia and New Zealand assumed special importance in policies designed to strengthen Australia's industrial base through the expansion of export markets.

Between 1950 and 1967, imports from Asia fell from 13 to 8 percent of total Australian imports. This largely resulted from reduced demand for raw materials. However, Asian countries are increasingly competitive suppliers of textiles and light manufactures and their share in Australian markets for these products has tended to grow at the expense of the United Kingdom and Japan.

Australia's preference scheme for imports from less developed countries should, at least partly, be viewed in the context of trade policies designed to extend trade interests in less developed country markets, especially in Asia and the Middle East.

III Criteria for Pacific Economic Integration

Intensity of trade indexes have been used by Kojima as criteria for assessing the desirability of economic integration. This would seem a useful approach. Two countries trade more or less intensively with each other than they do with the rest of the world because of the particular commodity composition of their trade in relation to that of world trade, or because of their geographical proximity and special institutional and historical ties. These two factors, the first of which may be called the degree of complementarity in bilateral trade, and the second of which may be called the degree of special country bias in bilateral trade, jointly determine the intensity of trade between two trading partners.

In the literature, a distinction is made between what may be called observed and potential complementarity among trade partners. Consequently, it might be argued that observed complementarity is an inadequate criterion for assessing the desirability of economic integration. However, such an argument seems of doubtful empirical relevance. Trade policies rarely distort the whole structure of a country's trade specialisation so much that generalisations about complementarity between pairs of countries cannot be made on the basis of observed trade specialisation.

The concept of 'complementarity' is often used loosely in economic literature to describe the extent to which countries have dissimilar resource endowments and structures of production and are therefore likely to trade intensively with each other. But the term is rarely defined precisely. Here the concept is defined in a very precise way. It is defined in a relative sense and measures the extent to which one country's export pattern matches another country's import pattern more closely than it matches the pattern of world imports. An index of the degree of complementarity in bilateral trade (C_{ja}) can be derived to measure exactly the extent to which country J's exports to country A are relatively large because the commodity composition of J's exports matches that of A's imports more closely than it matches the commodity composition of world trade. It follows that for each pair of countries, in a many-country, many-commodity world, there are two measures of the degree of complementarity in bilateral trade - one is derived from the flow of J's exports to A, and the other from the flow of A's exports to J. This index and associated indexes are defined algebraically in Appendix I.

The concept of special country bias in bilateral trade (B_{ja}) is defined to measure the extent to which J's exports have more or less favourable access to A's import markets than might be expected from both countries' shares of world trade in each commodity.

Trade policy also distorts the pattern of special country bias in trade. Country bias in Australian, Canadian, and New Zealand trade policy in the form of British preferential arrangements tends to mitigate against more intensive trade with Japan and the United States. Thus, high degrees of special country bias in these countries' trade with Japan and the United States would suggest that other natural geographical, political, and institutional barriers to trade were relatively low and that there was a strong case for closer economic integration amongst these Pacific countries.

The results of a detailed study of complementarity, special country bias, and intensity in Pacific region trade flows are presented in Table 1. The methods by which these indexes were calculated, and a brief description of the data upon which the calculations were based, is presented in Appendix I. Row c records the degree of complementarity, row b records the degree of special country bias, and row i records the intensity of trade index for each bilateral trade flow. Take Australia's export trade with Canada. The result of

TABLE 1

Complementarity, Special Country Bias, and Intensity in Pacific Asia Trade, 1965[a]

Exports to / Exports from		Australia	Canada	Japan	New Zealand	United States
Australia	c.		52	176	59	81
	b.	-	67	228	2029	126
	i.		35	401	1197	102
Canada	c.	86		115	83	123
	b.	112	-	74	99	415
	i.	96		85	82	510
Japan	c.	118	109		142	99
	b.	182	55	-	91	264
	i.	215	60		129	261
New Zealand	c.	18	29	122		70
	b.	1406	96	98	-	161
	i.	253	28	115		112
United States	c.	125	127	99	112	
	b.	110	350	158	68	-
	i.	137	446	156	76	

a. Row i measures the intensity of trade. An index of 100 indicates that one country exports (exports) exactly that share of her total exports to (from) another country as that country's share in world trade.

b. Row i equals row c multiplied by row b divided by 100.

Source: Calculations based on data described in Appendix I.

this study reveal that, simply because of the character of Australian export specialisation and Canadian import specialisation in world trade, Canada's share in Australia's export trade should be 52 percent as large as her share in world imports; further, that Canada's share in Australian exports is only 67 percent as large as might be expected from both countries' shares in world trade of each commodity; and that, therefore, Canada's share in Australia's export trade is only 35 percent as large as might be expected from her share in world imports. That is, the degree of complementarity in Australia's export trade with Canada is 52, the degree of special country bias is 67, and the intensity of trade is 35.

The general picture which emerges from Table 1 is that trade among advanced Pacific countries is highly intensive. There is a high degree of complementarity in trade between Japan and Australia, Japan and Canada, Japan and New Zealand, the United States and Australia, the United States and Canada and the United States and New Zealand, and a fairly high degree of complementarity in trade between Japan and the United States. The degree of special country bias is high in all trade flows except Australia's export trade with Canada, and Canadian - Japanese trade, so that even where the degree of complementarity is relatively low, intensity in trade remains high. Canadian trade is heavily oriented towards the East Coast and the United States and natural barriers to trade with Japan and Australia appear larger than might otherwise be expected. On the other hand, the index of country bias for Canada's export trade with Australia is reasonably high in consequence of both preferred treatment in Australian markets and the association between trade and capital flows. All trade partners have a high intensity of trade with the Pacific region as a whole, the highest being in Canada's export trade (354) and the lowest being in New Zealand's export trade (109). The relative size of the complementary and competitive trade flows suggests a strong case for closer Pacific economic integration.

Here the focus of attention is Australian trade. The intensity of Australia's export trade with the Pacific region (181) is very high. The intensity of her import trade (126) is also high.

Australia's export trade with Japan and the United States reveal the highest degree of complementarity whilst complementarity in export trade with New Zealand and Canada is relatively low. Observed complementarity in her export trade with the United States probably understates potential complementarity significantly. Complementarity in export trade with New Zealand and Canada is perhaps larger than might have been expected from a superficial consideration of the broad structures of the three economies. These indexes evidence Australia's stronger export specialisation in manufactures as, too, does a comparison of complementarity indexes for Australia's export trade with those for Canada and New Zealand. Australia lies squarely between Canada and New Zealand as an industrial exporter.

Special country bias in Australia's export trade with New Zealand is extremely high; it is large in export trade with Japan; and it is also relatively large in export trade with the United States. The extremely high degree of special country bias in export trade with New Zealand results from geographical nearness, preferred tariff arrangements, and market familiarity. Australia's new manufactured exports are heavily concentrated in the New Zealand market. Much of the special country bias in Australia's export trade with Japan is accounted for by the influence of transport costs and the special nature of Australia's trade with Japan in raw wool. Transport costs were ranked alongside indexes of special country bias for Australia's major exports to Japan. The degree of correspondence proved remarkably high. The coefficient of rank correlation was + 0.65, which is significant at the 99 percent level. Similar tests, in which relative transport costs were ranked alongside indexes of special country bias for major suppliers of various bulk commodities to Japan yielded similar results. Assymetry in economic distance appeared to account for much of the unexplained variance.

The degree of complementarity in Australia's import trade with Japan and the United States is high, and it is also relatively high in import trade with Canada. However, it is extremely low in import trade with New Zealand. Special country bias in import trade with Japan is now remarkably high, and reflects factors already discussed above. Special country bias in import trade with Japan had been as low as 46 in 1956. As might be expected, there is extremely high special country bias in import trade with New Zealand and relatively high special country bias in import trade with the United States, the latter being largely explained by the association between the capital and trade flows.

It is pertinent to compare these indexes of complementarity, special country bias and intensity in Australia's trade with the Pacific and similar indexes calculated for Australia's trade with the United Kingdom, Australia's major trading partner outside the Pacific region. The degree of complementarity (157) and special country bias (140) were relatively high for Australia's export trade with the United Kingdom, yielding a very high index of trade intensity (220). The degree of complementarity (136) was high for Australia's import trade with the United Kingdom, and the degree of special country bias (243) and trade intensity (330) were very high. Though a large part of special country bias in United Kingdom - Australian trade can be attributed to preferential tariff treatment and long established trade relations, it emerges that a large proportion of this trade is based upon high degrees of complementarity in trade specialisation and, therefore, that the costs of trade diversion on this trade flow could be large if Australia joined a Pacific Economic Community. This is also true to a lesser extent of Australia's relatively intensive trade with Asia.

However, there seems a fairly strong presumption in favour of Australian participation in Pacific economic integration. The Pacific constitutes a major part of Australia's economic world. There is a high degree of complementarity in Australian trade with principal Pacific basin countries. And there is a high degree of special country bias in trade with almost all potential Pacific partners despite the fact that British Preferential arrangements work against it in the case of the two largest Pacific economies.

IV The Impact Effect of PAFTA on Australia

The precise effects of Pacific economic integration upon the Australian economy are impossible to predict precisely. But the general effects can probably be forecast clearly enough. First, an estimate of the impact effect of Pacific tariff elimination upon trade expansion is presented. This enables rough specification of both the important direct gains from integration as well as the important costs of adjustment associated with integration. Later, the significant dynamic effects on the Australian economy are considered.

A detailed study, using national tariff data and three or four digit SITC commodity trade data for 1965, was made to estimate Australian import and export expansion in consequence of the elimination of Pacific area tariffs.

The impact effect of tariff reductions on trade depend upon the height of the original tariff, changes in tariff rates, and the relevant price elasticitics of demand and supply. Assuming infinite elasticities of supply, the change in imports (and exports) can be measured using the formula:

$$\Delta M = a \frac{t}{100+t} \eta M$$

where ΔM is the change in imports du to tariff reduction, a is the rate of tariff reduction, t is the original tariff level, η is the price elasticity of import demand, and M is the original value of imports.

The price elasticities of import demand used in this study are basically those adopted by Kojima in an earlier study. However, they have been modified to incorporate superior estimates of price elasticities for agricultural commodities of importance in Australian exports.

Estimates of the effect of Pacific area tariff elimination are presented in Table 2. As Kojima discovered in his earlier study, the height and structure of Australian tariffs and relatively high price elasticities of demand for Australian imports would lead to a substantial increase in imports. On the other hand, lower tariffs and lower price elasticities of import demand for Australian exports to Pacific countries restrains export expansion that would follow Pacific area tariff elimination. Nonetheless, both import and export expansion would be considerable, even if it tended to worsen Australia's balance of payments. Elimination of the increased deficit in international payments would require a 6-7 percent devaluation of the exchange rate or, more appropriately, compensatory measures which had an equivalent effect.

These estimates suggest an even larger expansion of trade and benefits from integration than Kojima's most recent estimates. The differences in estimation result from the use of slightly different price elasticities, the use of more detailed Australian tariff data, the use of weighed and selected tariff rates rather than average nominal rate, and allowance for the effect of quantitative restrictions on agricultural and mineral imports into Japan and the United States. In fact, the estimates of import expansion are probably still conservative since effective rates of protection are very high for some import competing industries in Australia and use of nominal rates understates the implied decrease in import prices in the most sensitive areas of production.

TABLE 2

The Effect of Pacific Area Tariff Reductions on Australian Trade, 1965

($USm)

	Merchandise Imports	Merchandise Exports
Trade with World	3350	2970
Trade with Pacific	1268	1075
Increase in Trade with Pacific	751	187
Percentage Increase on Trade with World	17.4%	6.3%

Source: Calculations are based on methods and data described in the text.

A rough attempt was also made to ~~guage~~ gauge the effect of import expansion on production and employment in import-competing manufacturing activity. The largest declines in production would be located in textiles (12-13 percent), metals and machinery (8-9 percent), miscellaneous manufactures (8-9 percent), and chemicals (6-7 percent). Motor vehicle production accounts for 21 percent of the decline in metals and machinery, electronics and electrical apparatus account for 10 percent, and light machinery and appliances account for 5 percent. The fall in chemical production is probably grossly underestimated since the prevalence of special protective measures for that industry makes it difficult to estimate the height of the tariff satisfactorily. Hence, the total decline in manufacturing production, if estimated import expansion were the only effect of tariff elimination, would be of the order of 6 or 7 percent. The structure and size of these change imply the necessity to re-deploy about 100,000 to 110,000 industrial employees or about 8 to 9 percent of the manufacturing work force in 1965.

These estimates are simply designed to illustrate the general magnitude of the adjustment problem in static circumstances, and to draw attention to the need for measures to minimize these costs. In fact, there is likely to be compensating export expansion in some manufacturing sectors, and the dynamic effect, for better or for worse, have yet to be considered.

V The Dynamic Effects of PAFTA on Australia

The dynamic effects of a move towards Pacific economic integration are likely to be by far the most important effects for relatively small economies such as Australia and New Zealand. Though it is impossible to quantify these effects, even as approximately as the static effects have been quantified, something can be said about the direction they may take.

Knowledge of trading partner economies is a precondition for trade. Although hitherto largely unanalysed, increased knowledge is a most important source of gains from more intensive regional trade. What structural changes are likely to be wrought because of the knowledge effect through Pacific economic integration?

The economic consequences of imperfect knowledge are manifested internationally as factor immobility (lack of awareness of employment possibilities in other countries), domestic orientation in consumption (lack of awareness of the commodities and uses of commodities produced in other countries) and domestic orientation in production (failure to produce for potential overseas markets, lack of knowledge of production processes, organisational forms and the products of firms operating in other countries, lack of awareness of foreign sources of raw materials and semi-processed industrial inputs).

Pacific economic integration is likely to promote economic welfare through the extension of knowledge in three ways. First, the establishment of an institution such as an Organisation for Pacific Trade Aid and Development would facilitate contact between businessmen and public servants in Pacific countries. Existing vehicles of communication, like the Pacific Basin Business Co-operation Committee, would be strengthened and given new purpose. Second, the establishment of PAFTA would direct the interest of individuals in each country to the economies of partners. Third, increases in the volume of international transactions in themselves are associated with gains in knowledge.

Greater knowledge will raise economic efficiency by promoting both commodity and capital movements. Greater knowledge of the uses of foreign goods will allow consumers to adapt their purchases to their tastes more rationally. Producers will be more willing to tap foreign technology and sources of raw materials. These benefits are likely to be of special importance of Australia.

Other structural changes will also be important. Integration would change the degree and nature of competition in each partner and modify attitudes to economic efficiency. For Australia, these benefits might be counted as of a high order. Australians, proudly, are the Norwegians of the Pacific. There can be little doubt that the diminished pressure is bought at high cost in terms of output of commodities.

Stronger competition among Pacific country producers would force more rapid dissemination of the most efficient techniques of production and methods of organisation employed in Pacific basin countries. These effects are also likely to be of considerable importance to the smaller economies.

It is likely that there will be some tendency towards establishing uniformity in other institutions. Labour markets are quite differently organised in Japan and the other four prospective members, with major differences, as well, between Canadian and American and New Zealand and Australian labour markets. Strong upward pressures on wages and labour conditions in the southern partners could well prove incompatible with the maintenance of free trade unless there were continual (and undesirable) exchange rate adjustments. Some Australians may fear that only stronger labour organisations in Japan would diminish this danger.

Important structural change is more likely to occur and will be of greater importance in industries which are subject to economies of scale. The effective PAFTA market for a commodity is a function of national income and tastes in member countries. Although consumer preferences differ in member countries, Pacific economic integration would vastly increase the size of markets for mass-produced commodities. There are numerous cases of industries subject to economies of scale operating at sub-optimal capacity in Pacific countries. The potential gains for such industries are is clearly greater in smaller countries. However, the introduction of intra-area free trade would induce a strong tendency for all production to migrate to countries with the largest internal markets - usually the United States and Japan. The destruction of national industries in smaller economies could result in capital outflow, unemployment, and balance of payments difficulties. Provisions would have to be made through OPTAD to minimise these effects by promoting and directing capital movement into less industrialised partners. In industries in which national location is unimportant, there is room for the negotiation of location. In some, OPTAD intervention could cause more efficient location.

The question of capital movements is inseparable from the question of freer trade, and of enormous importance to Australia. PAFTA would affect capital movements in three ways. First, the establishment of a Pacific Bank for Investment and Settlement would facilitate the directing of capital movements for balance of payments, income growth, or employment reasons. This would be made feasible by the likelihood of a net improvement in the balance of payments position of the region as a whole. The balance of payments of the United States and Japan is likely to be strengthened, and a major constraint on capital outflow from PAFTA's potential capital exporters removed.

Second, capital movements will be affected by changes in the relative profitability of investment in various countries. The incidence of specific capital increases the importance of this factor. Already a major share of Australian capital inflow is being directed towards low cost export - oriented mineral industries. The removal of regional tariffs would increase the attractiveness of investment and capital inflow in metal based industries.

Third, PAFTA is likely to promote capital movements by increasing knowledge of investment opportunities in other countries and reducing the risks of foreign investment. The strengthening of regional balance of payments and reduction of the risk of devaluation could also contribute to this effect.

This consideration of dynamic effects of relevance to Australia has been far from comprehensive. But it seems clear enough that the gains from Pacific economic integration would be far larger than analysis of the static trade expansion effects alone would suggest. There would have to be safeguards against the centralisation of production in the more highly industrialised economies, or PAFTA is unlikely to be attractive to the smaller economies. But these safeguards need not be inconsistent with longer run economic efficiency, especially if they take the form of promoting capital movements to facilitate production in less highly industrialised countries which possess significant natural advantages in some manufacturing industries.

VI The Feasibility of the PAFTA Alternative for Australia

A full treatment of the feasibility of Pacific economic integration would demand an assessment of the acceptability of each prospective partner's demands to the others. As a contribution towards a fuller treatment, some of the Australian political and economic attitudes that are relevant to whether or not a political decision could be taken in favour of Pacific economic integration.

Two broad types of attitude against Pacific economic integration can be identified. The first encompasses various aspects of the protectionist attitude . The second includes opposition to closer economic integration with Pacific countries at the expense of contacts with other countries and regions.

Australian protectionism has had as its prime objects the full employment of a workforce growing rapidly through migration, and long term income growth through the development of an infant economy or infant industries.

Both objects have been served more than adquately by the existence of a manufacturing industry has been ample justification for its continued protection. Though there has been a radical change in thinking about tariff policy, the sudden euthanasia of large sectors of existing inefficient manufacturing activity would be quite impracticable. Any move towards freer trade would have to be gradual, with care being taken to prevent too great an impact on existing import competing capacity.

The employment principle is associated with the industrialisation principle in Australian protectionism. Full employment is the first article of economic faith of all Australian political groups. Even given the expansion likely to result from freer Pacific trade, neither the rapidly growing capital-intensive mining sector nor the agricultural and pastoral sectors are capable of absorbing Australia's rapidly growing workforce. Moreover,despite some pride in their rural history, Australians probably share the widespread prejudice that in some non-economic sense urban activities are "superior" to rural activities. Hence, to receive strong support in Australia, PAFTA must give rise to shifts between industries within the manufacturing sector rather than shifts between manufacturing and other sectors. Some manufacturing industries would rapidly with free trade across the Pacific. Others could expand if the capital and technology became available. But provisions would have to be made for the artificial stimulation of manufacturing if it appeared that the free workings of the economy were not maintaining the size of the manufacturing sector. And it must be made obvious in advance that immediate action would be taken to remove large unemployment or industrial decline.

The infant economy principle in protectionism has been of pre-eminent importance in postwar Australia. There is no doubt that protection did promote rapid growth in the industrial sector. Now that a broad industrial base has been established, selection of industries with long term prospects of efficient production is becoming a more important criterion in tariff policy. These developments serve to reduce the opposition to wholesale dismantling of the Australian tariff against Pacific countries. But true infant industries do remain. It would be both uneconomic and politically unacceptable to adopt a policy that led to the decline of industries with long term prospects of efficient operation. PAFTA agreements would have to include provisions for the continued protection of infant industries. There are dangers of abuse in a free trade agreement that exempts particular commodities - the Australian - New Zealand Free Trade Agreement is a classic case of vested interests securing a tariff structure that produces a maximum of trade diversion and a minimum of trade creation. Great care must be taken to establish the credentials of an applicant for continued protection.

The second source of resistence - the weakening of Australia's association with countries outside PAFTA - is hardly less important. Relations between Australia and the United Kingdom, Australia and the Territory of Papua and New Guinea and Australia and the developing countries of Asia and South-East Asia require comment.

The special relationship with the United Kingdom has loosened considerably over the past decade. The weakening of economic ties with Britain would no longer appear as an important constraint on policies towards Pacific economic integration. However, should Britain's bid to enter Europe fail, moves towards Australian and British association in a larger PAFTA - NAFTA union would be regarded sympathetically.

Special provisions would have to be made for the Territory of Papua and New Guinea. Australia grants the Territory preferential treatment on some of its exports and this treatment is not reciprocated. In addition, over two-thirds of Australia's overseas grants in aid are directed into New Guinea. Australia's interests in this regard could be satisfied if the Territory was granted status in PAFTA equivalent to that it now enjoys in relation to Australia. Such provisions could be made at negligible cost to other PAFTA countries.

More subtle, and more difficult to accomodate, is Australia's relationship with the countries of South-East Asia. Australia's strategic and economic interests in the economic development of South-East Asia are, with those of Japan, greater than those of other PAFTA countries. Australia's trade with most countries of the region has been growing rapidly in recent years. The idea of trade between the rich countries of the Pacific burgeoning at the expense of the economic interests of other Asian and South-East Asian countries is antipathetic to a strong and growing part of Australian sentiment and policy. The eclipse of the current vision of Australia developing as a part of Asia, to the mutual advantage of all members of the region, would be retrograde.

Associate membership status might prove the most acceptable solution to this problem, coupled with programmes for aid and development. Australia's interests in this regard would be amply satisfied if Asian and South-East Asian countries were granted preferential access to PAFTA markets, but remained free to impose their own tariffs. The extremely limited scope of current Australian preferences for less developed countries, suggests that this solution could only be adopted gradually because of the protectionist constraint.

VII Conclusion

Australian participation in Pacific economic integration would have the benefits associated with a significant move towards freer trade. Incomes would rise as a result of the direct effects on trade volumes. There are also likely to be important dynamic benefits, through improved access to international capital and technology.

The main costs of Australian involvement in Pacific economic integration would be the costs of adjustment resulting from the need to re-allocate labour capital and other resources out of less efficient import-competing industries into more efficient domestic production, the costs of trade diversion, the costs of perverse capital movements, and the political costs of any shift of emphasis in international relations too much towards the Pacific and away from Asia.

These costs can be exaggerated. In a growing economy the costs of re-allocation need not be so great. Moreover, the great merit of the regional approach over the multilateral approach to freer trade is that close co-operation between partner countries can help minimise the costs of adjustment. Because the Pacific is such a large part of Australia's trading world, the costs of trade diversion are likely to be minimal. Furthermore, insofar as the trade needs of nearby less developed countries can be accommodated by the extension of trade preferences under an associate membership scheme and the provision of increased developmental assistance, the costs of trade diversion and the political costs would be minimised.

The costs of adjustment could be greatly reduced if a Pacific Industries' Council were established in each partner country to adjudicate cases of "undue harm or injury" to import competing sectors affected by tariff elimination. These Councils would serve a similar function to the Advisory Authority instituted under the Japanese - Australian Trade Agreement of 1957.

An Organisation for Pacific Trade, Aid and Development could co-ordinate the work of the five Pacific Industries' Councils, assess claims for continued infant industry protection, and assist with the rationalisation of regional industrial location so as to minimise agglomerating forces. Significantly, it could co-ordinate aid-giving by the five partner countries and provide assistance to private investors interested in investment in developing countries. It could also administer a system of associate membership for Asian (and no doubt Latin American) countries.

Finally, a Pacific Bank for Investment and Settlement could be established with the aim of facilitating investment and settlement within the region. This would ease the short term balance of payment problems and contribute to longer-run objectives by facilitating movements of long term capital, especially to countries like Australia.

Contacts in the Pacific area are already strong, not only in trade and commerce, but also in political and strategic matters. Already 38 percent of advanced Pacific country trade is intra-areal: that compares favourably with the 41 percent of intra-areal trade achieved within the European Economic Community. Pacific trade would undoubtedly continue to prosper without more formal regional arrangements but if we work gradually towards more formal arrangements, the potential for regional growth could be greatly enhanced, as too, could the potential for mobilising regional resources for more effective assistance to less developed countries in Asia and Latin America. Indeed, there seems a strong presumption that, at this turning point in her commercial history, Australia could do well by directing her international economic policy toward achieving closer Pacific economic integration.

Pacific Aid

APPENDIX I

This appendix defines briefly the new concepts introduced in the paper to analyse factors which affect the intensity of trade between trading partners. They are defined in (1) (4) (5) (7) and (8). Other concepts defined in (2) (3) and (6) are useful in understanding the logic and character of the main formulae and for more detailed analysis of trade intensity. For a fuller discussion see (9).

I_{ja} is an index of the intensity of country J's export trade with country A:

$$I_{ja} = \frac{X_{ja}}{X_j} \Big/ \frac{M_a}{M_w - M_j} \tag{1}$$

where X_{ja} are J's exports to A,

X_j are J's total exports,

M_a are A's total imports,

M_w are total world imports, and

M_j are J's total imports.

The intensity of trade index provides a measure of the extent to which country J's exports to country A are larger or smaller in relation to her exports to the whole world than country A's imports are in relation to world trade.

R^i_j is an index of J's specialisation in the export of commodity i:

$$R^i_j = \frac{X^i_j}{X_j} \Big/ \frac{M^i_w - M^i_j}{M_w - M_j} \tag{2}$$

where X_j^i are J's exports of commodity i,

X_j are J's total exports,

M_w^i are world imports of commodity i,

M_j^i are J's imports of commodity i,

M_w are total world imports, and

M_j are J's total imports.

The index of export specialisation provides a measure of the extent to which country J exports relatively more or less of commodity i than all other exporters on average.

D_a^i is an index of A's specialisation in imports of commodity i:

$$D_a^i = \frac{M_a^i}{M_a} \Big/ \frac{M_w^i - M_j^i}{M_w - M_j} \qquad (3)$$

where M_a^i are A's imports of commodity i

M_a are A's total imports,

and all other terms are as defined above.

The index of import specialisation provides a measure of the extent to which country A imports relatively more or less of commodity i than all other importers on average.

C_{ja} is an index of the degree of complementarity in J's export trade with A:

$$C_{ja} = \sum^{n} \left(R_j^i \cdot D_a^i \cdot \frac{M_w^i - M_j^i}{M_w - M_j} \right) \qquad (4)$$

or

$$C_{ja} = \sum^{n} \left(\frac{X_j^i}{X_j} \cdot \frac{M_w - M_j}{M_w^i - M_j^i} \cdot \frac{M_a^i}{M_a} \right) \qquad (5)$$

where all terms are as defined above.

The index of the degree of complementarity in trade provides a measure of the extent to which country J's export trade with A is relatively large or small because of the character of J's export specialisation and A's import specialisation in trade.

K^i_{ja} is an index of special country bias in J's exports of commodity i to A:

$$K^i_{ja} = \frac{X^i_{ja}}{X^i_j} \Big/ \frac{M^i_a}{M^i_w - M^i_j} \tag{6}$$

where X^i_{ja} are J's exports of commodity i to A, and all other terms are as defined above.

The index of special country bias for commodity i provides a measure of the extent to which J's exports of i have more or less favourable access to A's markets than other exporters of i.

B_{ja} is an index of overall special country bias in J's export trade with A:

$$B_{ja} = X_{ja} \Big/ \sum^n \left(X^i_j \cdot \frac{M^i_a}{M^i_w - M^i_j} \right) \tag{7}$$

where all terms are as defined above.

The index of special country bias in J's export trade with A measures the extent to which J's total exports have more or less favourable access to A's import markets than might be expected from the two countries' shares of world trade in each commodity.

Thus, the intensity of trade is a product of the degree of complementarity and special country bias in trade:

$$I_{ja} = C_{ja} \cdot B_{ja} \tag{8}$$

The Calculation of the Intensity, Degree of Complementarity, and Special Country Bias in Pacific Trade.

The results of calculations of the intensity, the degree of complementarity, and the degree of special country bias in trade amongst Pacific countries in 1965 are presented in Table 1. These calculations are based on three digit SITC commodity trade data assembled from United Nations, Commodity Trade Statistics, O.E.C.D., Commodity Trade: Imports, United Nations, Yearbook of International Trade Statistics, and national trade statistics. Estimates of the composition of world trade by the 178 commodity groups identified in the study were derived from data available in United Nations, Commodity Trade Statistics which recorded about 74 percent of world imports by SITC three digit classification in 1965.

The limitations of these measures are set out elsewhere
The effect of commodity classification on the proportion of trade intensity attributable to complementarity or special country bias deserves explicit note. In particular, completely reliable results can only be obtained if commodity groups are perfectly homogeneous.

Results in the text are quoted in index form. For example, when J exports to A exactly the same share of her total exports as A holds in world trade, the intensity of J's export trade with A equals 100 rather than unity.

APPENDIX II

Australia: Distribution of Imports by Major Trading Region

(Percent of Total Value)

Origin	1950	1955	1960	1961	1962	1963	1964	1965	1966	1967a.
Pacific:	15.35	19.20	27.19	33.10	32.33	34.56	37.18	39.79	40.03	42.23
United States	9.71	12.11	16.15	19.96	19.68	21.27	22.86	23.83	23.94	25.68
Japan	1.30	2.18	4.48	6.02	5.59	5.98	6.85	8.90	9.53	9.72
New Zealand	.92	.95	1.71	1.60	1.54	1.64	1.89	1.60	1.59	1.55
Canada	2.47	2.83	3.20	4.20	3.86	4.25	4.04	4.03	3.67	3.84
Asia:[b]	5.77	3.84	3.36	3.53	3.62	3.43	3.54	3.50	3.42	3.68
China	.27	.21	.48	.37	.43	.52	.69	.79	.80	.86
South-East Asia:[b]	7.58	8.68	8.28	6.38	7.28	6.05	5.31	5.19	4.57	4.24
Malaysia and Singapore	2.27	1.81	2.09	2.70	2.03	1.90	1.54	1.80	1.21	1.20
Indonesia	2.74	2.67	3.18	2.63	3.03	2.68	2.34	2.20	2.10	1.86
United Kingdom	51.81	44.88	35.61	31.31	30.06	30.45	27.78	26.21	25.81	23.74
Western Europe:[b]	9.22	14.76	16.25	16.50	16.51	15.68	16.06	16.63	17.51	16.98
France	1.98	1.74	1.48	1.54	1.25	1.64	1.69	2.30	3.12	3.05
Germany(Fed.Rep)	1.22	3.65	5.81	6.09	5.86	5.42	5.51	5.54	5.72	5.20
Italy	1.68	1.39	1.40	1.45	1.59	1.81	1.69	1.74	1.69	1.74
All Other	10.28	8.64	9.31	9.18	10.20	9.83	10.13	8.68	8.66	9.13
Total Australian Imports, $US m.	1205	1890	2075	2436	1982	2422	2657	3253	3292	3415

a. Years end 30th June.

b. Trading regions as defined in Vernon Reports, p. 1000

Source: Commonwealth of Australia, Oversea Trade (various issues) Canberra.

APPENDIX III

Australia: Distribution of Exports by Major Trading Region

(Percent of Total Value)

	1950	1955	1960	1961	1962	1963	1964	1965	1966	1967[a]
Pacific:	18.79	23.46	33.14	35.73	37.60	39.59	38.73	38.17	41.27	43.00
United States	8.09	6.77	8.10	7.48	10.12	12.35	10.09	9.96	12.44	11.87
Japan	3.91	7.57	14.36	16.67	17.35	16.09	17.53	16.62	17.29	19.39
New Zealand	3.47	4.88	5.80	6.40	5.46	6.09	5.98	5.97	6.29	5.84
Canada	1.47	1.36	1.48	1.76	1.63	1.77	1.81	1.51	1.59	1.71
Asia:[b]	7.29	5.48	4.98	8.01	10.66	10.27	9.41	9.62	7.37	10.13
China	.08	.35	1.72	4.11	6.12	6.01	6.04	5.12	3.92	4.33
South-East Asia:[b]	3.67	5.34	5.44	5.37	5.41	5.81	5.31	6.29	6.77	7.77
Malaysia and Singapore	2.22	2.58	2.52	2.64	2.69	2.95	2.48	3.13	3.08	3.91
Indonesia	.08	.48	.34	.61	.40	.29	.35	.28	.20	.23
United Kindom	38.71	36.88	26.37	23.90	19.16	18.66	18.40	19.47	17.40	13.34
Western Europe:[b]	22.05	24.05	20.54	18.02	19.31	17.45	17.26	16.31	17.89	15.52
France	6.63	8.27	6.43	5.27	4.83	4.92	4.94	4.22	4.35	3.34
Germany(Fed.Rep.)	-	4.11	4.09	2.76	3.79	3.18	3.30	3.16	3.69	2.47
Italy	3.16	4.64	4.97	4.93	4.84	4.09	3.90	3.21	4.05	4.19
All Other	9.49	4.79	9.53	8.97	7.86	8.22	10.89	10.14	9.30	10.24
Total Australian Exports, $USm.	1375	1734	2100	2170	2413	2410	3116	2970	3047	3400

a. Years end 30th June.

b. Trading regions as defined in Vernon Report, p. 1000

Source: Commonwealth of Australia, Oversea Trade (various issues) Canberra.

Notes and References

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Session III

Comment on K. Kojima's Paper by I.A. McDougall

Professor Kojima's paper provides us with an excellent and detailed analysis of trade flows within the five countries which he suggests should form a free trade area. We are all I am sure indebted to him for this statistical breakdown and for the stimulus which his earlier and present thoughts on this proposed free trade area have provided for the participants in this Conference. His paper raises a large number of issues many of which have already been discussed and I shall endeavour in my comment to avoid repeating comment upon these points.

Part I of Prof. Kojima's paper shows clearly that trade among the five Pacific area countries has been growing rapidly, although less rapidly than has intra-European trade. The growth centres of Pacific trade have been the U.S.A., Australia and Japan and trade has increased most in heavy manufactures and chemicals as well as in sophisticated light manufactured goods.

I do not believe, however, that these facts support all of the conclusions and policy suggestions which Prof. Kojima derives from them. The mere fact that trade has been expanding in a particular geographic area does not in itself provide an argument for integration. Even if it did one must pay attention to the way in which a region is constructed. For instance, in the time period selected U.S.A. trade with Europe was not only absolutely larger than with the Pacific area but also showed a greater percentage increase. This would suggest, according to Prof. Kojima's reasoning, that the U.S.A. and perhaps Canada would do better to seek some European or North Atlantic trade grouping if any at all.

The fact that extended Pacific trade has not expanded as rapidly as intra-European trade is according to Prof. Kojima another reason for proceeding with integration in the Pacific. This ignores, however, the fact that intra-European trade might well have expanded for reasons other than the promotion of the EEC. Furthermore, it may well be that the development of the latent resources of the Pacific area may more urgently require policies other than an expansion of trading opportunities.

My final comment on Part I of this paper concerns Prof. Kojima's conclusion that because intra-area trade in the Pacific has expanded most in the field of heavy manufactures and chemicals "stimulation of horizontal trade in these goods seems to be the most promising route for trade expansion". I hope that he does not forget that trade expansion as far as Australia and New Zealand are concerned has been concentrated upon commodities other than heavy manufactures and chemicals and that the concept of horizontal trade applies also to these other commodity categories.

In Part II, Prof. Kojima measures the static effects of tariff elimination in PAFTA, compares these static effects with the gains to be had by PAFTA countries from the Kennedy Round and, finally, comments upon policy alternatives confronting Japan.

As far as the computation of the static effects of tariff elimination in the PAFTA countries is concerned, Professor Kojima makes use of a technique explained more fully in another paper. I have already indicated that the assumptions on which these conclusions are based give me cause for concern. First, although Prof. Kojima is in good company when using the elasticities of import demand developed with respect to the U.S.A. by Bull and Marwah, it seems to me that these elasticities which relate to broadly aggregated commodity groups cannot with any confidence be uniformly applied to such different economies as Japan, Australia and New Zealand. Secondly, even although only static effects are being calculated, one needs to know something about effective rather than nominal rates of protection if the effects of trade creation are to be accurately assessed.

Thirdly, Prof. Kojima has assumed away the effects of trade diversion and these could significantly alter not only his implied estimate of gains but also the distribution of benefits and losses among the individual members. Finally, Prof. Kojima's method of calculation requires the further assumption that terms of trade effect would be negligible (despite large structural charges in the volume and commodity composition of trade) and that the complication arising from non-tariff barriers can be assumed small. In my opinion these are very strong assumptions and while they suffice to give some conclusion of the approximate increase in the volume of intra-area trade I do not believe as Prof. Kojima suggests that they lend themselves to an assessment of the direct balance of payments effects of the establishment of a free trade area.

On the basis of the balance of payments effects detailed on p.164 of his paper, Prof. Kojima concludes that the industrialization of New Zealand, Australia and Canada would need to be promoted so that they can share in the benefits of expanding trade in heavy manufactures and chemicals. This conclusion, however, depends upon the sets of assumption underlying his calculations of static effects and upon the dynamic effects of increased investment flows, economies of scale, and increased competition not working so as to eliminate these deficits. Moreover, in my opinion, it places economic development in Canada, Australia and New Zealand into a straight jacket not necessarily indicated by comparative advantage considerations.

I shall not comment upon Prof. Kojima assessment of Kennedy Round effects which depends upon similar assumptions to those mentioned earlier.

Prof. Kojima's first policy choice for Japan would be to expand free multilateral trade, but given that global tariff reductions are unlikely, his second policy choice is for the establishment of a Pacific Free Trade Area. A comment on p.170, however, suggests that a free trade area which did not include the U.S.A. would prove unacceptable to Japan. Perhaps Prof. Kojima would like to comment on this.

Apart from economic benefits, Prof. Kojima cites the interests of the developing countries as a further reason for seeking the formation of PAFTA.. This objective has already been commented upon by others.

Finally, in Part III Prof. Kojima makes several propositions for promoting closer Pacific trade relations. In view of what has been said one can agree with him that the moment is premature for the formation of a free trade area which would incorporate the U.S.A. (and therefore Canada).

I am disturbed, however, by his suggestion that in the meantime measures should be adopted to expand trade horizontally in heavy manufactures and chemicals but that levels of protection accorded light manufacturing and agriculture are at present too sensitive an issue for negotiation. As pointed out by Sir John Crawford this morning, levels of protection in these areas would need prove negotiable, if Australia and New Zealand were to participate in a free trade area involving themselves and Japan.

Finally, I need comment upon Prof. Kojima's three codes for better behavior in international trade and upon the international institutions he would recommend establishing.

A code of good conduct which could perhaps obtain agreement on the dumping of subsidized exports on commercial markets but I believe it unlikely that countries would relinquish the right to raise tariffs or impose quantitative restrictions in the event of balance of payments difficulties.

As far as the code of overseas investment is concerned, I am not clear how this would regulate the flow of foreign investment. Would it, for instance, prevent it from seeking its highest rate of return (perhaps in ventures not involving the production of heavy manufactures or chemical goods). Further, I do not understand the precise connection between a code of overseas investment and the probably irrational Japanese fear of the domination of U.S. capital. Perhaps Prof. Kojima might explain this point in greater detail. Further comment is also required by him on his suggestion for a code of aid and trade policy towards developing countries.

Of the two international organizations proposed by Prof. Kojima, one--The Pacific Bank for Investment and Settlement --has already been discussed in detail. The other--an Organization for Pacific Trade and Development--would have much merit even if a free trade area were not to be proceeded with in the near future, because it would facilitate a greater understanding of trade problems and in this way could assist in obtaining closer collaboration on trade, investment and aid in the Pacific Area.

Finally, Mr. Chairman, lest it be thought that I am doing no more than disagree with Prof. Kojima, let me add that I take it for granted that the many merits in his paper are apparent to all and do not require my elaboration: let me also again say how grateful I am personally to him for his provocative thoughts on this subject of a Pacific Free Trade Area.

Comment on P. Drysdale's Paper by Hisao Kanomori

Dr. Drysdale's paper is particularly interesting to me in two respects: the first is its discussion of the dynamic effects of integration and the second is its discussion of the criteria for effective integration. Some of these points have already been discussed but I should like to have them explained more fully.

As Dr. Drysdale's paper makes clear, there is an unusually close complementarity between Australia and Japan. Japan imports raw materials such as wool and iron ore, fuel such as coal, and foodstuffs such as wheat and meat and exports industrial goods. Thanks to this complementarity, the trade between the two countries has expanded rapidly. Complementarity will probably increase through growing imports of coal and iron ore. What is the effect of this complementarity on Australia's industrialisation? If, in future, the demand of industrial nations for foodstuffs and raw materials increases, as indicated by Dr. Okita yesterday, the terms of trade could be favourable to Australia and agricultural and mining production should be more profitable. Will that not check Australia's industrialization? Will the ratio of manufacturing industry in Australian economy increase or decrease when tariffs are lowered?

Is it necessary to prevent the centralization of production in the more highly industrialized countries? If the centralization results from economies of scale, an attempt to prevent it may be against the interest of international division of labour. Of course, the necessity for having some manufacturing industry is undeniable, but if the production of wool and iron ore are centralized in Australia, why does she consider it undesirable that industrial production become centralized in other nations? As the demand for raw materials will probably increase, and their supply become more scarce, the advantage of industrial countries over agricultural and mining nations may prove to be an illusion and not long-lasting. Can not agricultural countries exploit industrial countries in future? This is not my opinion but merely a question.

Suppose there is a rush of demand for Australia's raw materials from all over the world, and she can import industrial goods from any nation. On the import side, what kind of industrial goods will Australia import in future? Probably labour-intensive goods, judging from her factor endowment. However, Japan will probably export less labor-intensive goods, and more capital-intensive goods. In that case, the complementarity between Australia and Japan may weaken, and Australia may come to have a closer complementarity with the countries of Southeast Asia. Will she feel less attracted by the Pacific economic integration due to these factors?

As criteria for assessing the desirability of economic integration, the index of the degree of complementarity is an excellent device. From this index, we can calculate how closely the export structure of country A matches the import structure of country B. The intensity of trade between A and B is the product of the degree of complementarity and special country bias in trade. Using these indices, Dr. Drysdale has undertaken a brilliant analysis of the characteristics of the Pacific Area countries in Table 1 (p.202). A surprising feature of this table is that the degree of intensity of Australia's export trade with Japan is as high as 401. This is almost as close as the relation between the United States and Canada. On the other hand, the degree of intensity of Japan's export to Australia is not so high, only 215. In particular, complementarity is surprisingly low; it is lower than that between Australia and the United Kingdom, 136. Does this asymmetry of complementarity between export and import trade not mean that it might be advantageous for Australia to extend her trade to a wide area than PAFTA, especially in the event of a seller's market in foodstuffs and raw materials?

I should like to know how the index of complementarity between Australia and Japan has been changing. It would also be interesting to assume probable future changes in Australia's industrial structure and estimate the indices for such cases. They may provide useful insight into the future of PAFTA.

Discussion on Kojima's and Drysdale's Paper

In reply Prof. Kojima agreed that his estimates of the static effects of Pacific tariff elimination were rough but he maintained that they were useful in specifying the general magnitude of these effects. Moreover, the estimates have been improved by Prof. Wilkinson and Dr. Drysdale and they could be further improved by taking dynamic effects into account.

Prof. Kojima also agreed that his proposal for three codes of international economic behavior and two institutions to facilitate Pacific economic co-operation had not yet been studied fully. He hoped that colleagues in New Zealand and Australia would assist with this task. However, he felt that Prof. McDougall's objection to constraints on tariff-raising on the grounds that they would hinder balance-of-payments operations was wrongly based. An appropriate financial institution would more effectively serve to remedy balance-of payments problems.

Prof. Kojima also admitted the difficulty of estimating the dynamic effects which would follow the formation of a free trade area. He explained his emphasis on the role of horizontal trade by reference to European experience of growth in trade of manufactured goods. Whilst he appreciated concern in Australia and New Zealand about increased trade opportunities for primary commodities, such as butter, meat, cereals and other primary products, he felt sure that both countries could enjoy an expansion of exports from specialized manufacturing industries.

With respect to Japanese attitudes towards trade liberalization and Pacific economic integration, he agreed that there were strong protectionist attitudes amongst businessmen against the liberalization of capital movements and amongst farmers against liberalization of agricultural imports. His own opinion was a minority opinion but moves towards liberalization could and should be encouraged.

In reply to Mr. Kanamori's comments, Dr. Drysdale made three main points.

First, he stressed that whilst his estimates suggested that there would be a significant re-arrangement in the pattern of Australian manufacturing activity in consequence of moves towards freer trade, it seemed very unlikely that the ratio of manufacturing to primary activity would decline. The most important sectors of industry, such as iron and steel, metal based industries, and motor vehicles, are already quite competitive and they would probably become more competitive with freer trade.

If the effect on capital flows was not perverse, and Dr. Drysdale was optimistic in this respect, this conclusion would be reinforced. In general, he felt that Mr. Kanamori was too optimistic about likely trends in the terms of trade for primary commodity exporters.

Second, Dr. Drysdale was skeptical about the possibility that Australia would become a major exporter of minerals to the whole world in the very near future. He emphasised that his study indicated that Australia's mineral exports would continue to be heavily concentrated on near markets, such as Japan, although there had already been some small shipments of iron ore to Europe. The economics of transportation for these bulk commodities still dictate heavy geographic concentration in exports.

Finally, Dr. Drysdale agreed that it would be useful to develop indexes of complementarity and country bias for predicting trade flows and said that he was keen to do that. He also agreed that it was interesting to look at changes in these indexes over time, and especially changes in the index of complementarity for Japan's export trade with Australia. He said that, in fact, the index of complementarity in this trade had tended to decline recently but that this trend requires careful interpretation. He argued that the decline was transitional and resulted from the change in Japan's export specialisation from light to heavy industrial goods. He stressed that, contrary to Mr. Kanamori's belief, Australia was a major importer of capital-intensive goods, and that she would continue to specialise in the import of these goods. Since Japan was becoming an increasingly significant exporter of these products relative to other industrial traders, the index of complementarity in Japan's export trade with Australia can be expected to rise markedly. Dr. Drysdale therefore suggested that Australia's interest in Pacific economic co-operation will remain strong. Australia could not be an efficient industrial producer and exporter to Asia without close Pacific trade connections.

Discussion centred on two related themes which had been developed in both papers. The first was the possibility that, without policy safeguards, factors of production might tend to migrate towards larger economies and have perverse effects on the industrialisation of smaller economies, following moves towards freer trade. The second was the basis for increased horizontal trade among advanced Pacific countries.

It was asked whether there was any evidence of the migration of factors between New Zealand and Australia consequent upon the New Zealand-Australia Free Trade Agreement. It was explained that this was a major fear of New Zealand policy-makers and industrialists and a major reason for the limited nature of the agreement. However, there was little empirical evidence one way or the other yet because of the limited operation of the agreement.

A New Zealand participant suggested that it was possible that New Zealand manufacturing activity would expand within the framework of the New Zealand-Australia Free Trade Agreement, and cited the growth of manufacturing activity in smaller centres in Australia as further evidence that "agglomerating" forces may not be strong if there were a move towards freer trade. It was pointed out that there may be external diseconomies associated with "agglomeration" and this illustrated with reference to New Zealand and Japan.

On the other hand, others from Canada and Australia, drew attention to the importance of policy influences in this regard and stressed the importance of external economies in fostering concentration on initially large markets. A Japanese participant suggested that technological efficiency might be an important determinant of location, even for resource-intensive manufacturing industries, and cited the competitiveness of the Japanese and Italian iron and steel industries as evidence of this.

Three significant influences on the location of manufacturing activity were noted. First, it was argued that for primary manufacturing and processing location would be dictated largely by resource availability. Second, for secondary manufacturing, Research and Development were important determinants of efficiency, and it was felt that the concentration of Research and Development activity was likely to lead to concentration in production and location. Finally, for mature secondary manufacturing industry, in which Research and Development had become relatively unimportant, it was argued that location would again be determinated more by the availability of cheaper resources including labour. These observations were discussed with reference to North American experience.

Some saw the main basis for improved industrial specialisation and increased horizontal trade in these factors, especially in the first and third factor. It was argued, however, that free market forces might not always lead automatically to this improved specialisation and that this would be a legitimate concern for smaller economies. Prof. Kojima suggested, for example, that the problem of market franchise restrictions would have to be controlled within the framework of his Code for Overseas Investment.

Chapter 7 A NEW WORLD TRADE POLICY IN THE POST-KENNEDY ROUND ERA:

A SURVEY OF ALTERNATIVES, WITH SPECIAL REFERENCE TO THE POSITION OF THE PACIFIC AND ASIAN REGIONS

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I Introductory Observations

The intention of the Administration of the United States, in preparing the Trade Expansion Act of 1962 as the basis for the Kennedy Round of GATT negotiations, was to contain the regionalizing and discriminatory effects of the formation of the European Economic Community within a broader movement towards free world trade on a non-discriminatory multilateral basis. Much of that objective had to be written off when Britain was denied admission to the Common Market, with the result that the scope of the "dominant supplier authority" of the Trade Expansion Act, which authorized elimination of tariffs on industrial products on which the U.S.A. and the E.E.C. together conducted eighty percent or more of free world trade, shrank to insignificance. Reliance then had to be placed on the authority to negotiate linear tariff cuts of up to 50 percent on industrial products, which it was hoped would still provide scope and incentive for a substantial freeing of trade. As the negotiations slowly dragged along, however, many proponents of freer trade began to fear that the Kennedy Round would be a failure, and consequently to believe that some other method of approaching free trade than negotiations for tariff reductions in GATT would have to be resorted to. At the same time, many came to the conclusion that, particularly for the smaller and less mature industrial countries, the mere lowering of tariff barriers was insufficient to enable a full harvesting of the major benefits that free trade might afford - the opportunity to exploit the economics of fine specialization of activities and associated economies of large scale production on the basis of assured access on equal terms to a really large and competitive market. Consequently, the attention of many policy experts in various countries turned to the possibilities of an alernative route to free trade, the establishment of complete free trade on a regional basis - and specifically, for reasons which are discussed below, the establishment of free trade areas rather than customs unions. For some, regional free trade was regarded as the natural response of the policy of countries situated elsewhere to the regional discrimination implicit in the formation of a European Economic Community that appeared unwilling to negotiate reductions of its external tariffs on a basis of reciprocity. For others, probably the majority, however, the free trade area approach was visualized as a method of by-passing European protectionism and continuing the momentum of the postwar trend towards freer trade, while at the same time building additional bargaining power to overcome European resistance to the multilateral freeing of trade.

The eventual successful conclusion of the Kennedy Round necessarily altered the situational assumptions of this position in several important respects. Most notably, it demonstrated that the European Economic Community was not obstinately and incurably protectionalist, as contrasted with the other major industrial nations, but rather that protectionist interests were prevalent in all the negotiating countries, but could be subordinated to more general national interests in the freeing of international trade. It thus became possible to contemplate openly the concept of world free trade as an ultimate objective, and to consider alternative trade policy arrangements for the future, as different strategies for securing that same end, rather than as political instruments for retaliation and coercion.

At the same time, the painful protraction of the Kennedy Round negotiations and the exhaustion of the negotiators that they produced, give good reason to doubt both that the major industrial nations would be willing to undertake a similar exercise in the near future, and that if undertaken it would produce significant, let alone comparable results. In addition, the Kennedy Round failed to make significant progress with respect to two problems that are of great concern to important categories of countries, and with which it was intended to deal, the reduction of barriers to trade in agricultural products, and the opening of markets in the developed countries for exports of both primary products and manufactured and semi-manufactured goods from the developing countries on a non-reciprocated basis. These features of the outcome both underline the desirability of considering approaches towards free trade by methods alternative to that of multilateral negotiation of reduction of trade barriers through G.A.T.T., and suggest that some of these approaches may be better able to cope with the problems of barriers to trade in agricultural products and developing country exports than multilateral negotiations may be expected to do.

In addition to recognizing these implications of the conclusion of the Kennedy Round, an evaluation of trade policy alternatives for the future must pay at least some attention to the implications of recent developments in international monetary affairs, and of France's veto on consideration by the European Economic Community of Britain's application to join the Common Market.

The recent sequence of international monetary disturbances, involving the devaluation of sterling, the rush of speculation on gold against the dollar, and the necessity of the imposition by the United States of new restraints on private investment overseas by industrial and financial corporations and reductions in overseas defense and development assistance expenditures by the United States government, has two major implications for possible alternative new trade policy arrangements. One is that the upsurge of protectionism in the United States in 1967, that folowed so closely on the completion of the Kennedy Round and caused so much concern among the other Contracting Parties to GATT, is likely to be strongly reinforced by arguments drawn from the state of the balance-of-payments. The United States Administration, therefore, far more so than in 1962, will be able to contemplate only those new initiatives towards free trade that either promise on net to improve the balance of payments, or promise to serve some overriding national interest in world politics, or preferably (as in 1962) both interests simultaneously; and it may in fact be unwilling for balance-of-payments reasons to contemplate any immediate move towards free trade, which could mean that any such initiative would have to be taken on a smaller, and in all likelihood, more narrowly regional, basis. At the present time, the constellation of circumstances that would most probably evoke a new U.S. initiative would be the opportunity to strike back at the countries of the European Economic Community, from which the external pressure for the new restraint policies has come, through the formation of a free trade area with E.F.T.A. and Canada that would discriminate strongly against E.E.C. exports of manufactures. But the development of the war in Vietnam might lead the United States to contemplate a Pacific Free Trade Area as a means of strengthening its political position in Asia vis-a-vis Communist China. In relation to either of such regional arrangements, the U.S. concern with the position of the dollar would be likely to make it anxious to trade off the relatively greater gains to its partners than to itself from the freeing of trade, against monetary arrangements committing its partners to support of the dollar.

The other important implication of recent monetary developments concerns the developing countries. The first United Nations Conference on Trade and Development originated in the realization that prospective supplies of development aid would fall far short of the prospective needs of the developing countries, and the consequent demands of these countries that aid should be supplemented by new trade policies on the part of the developed countries designed to increase the market opportunities and export earnings of the developing countries. The force of this appeal has been recognized both in the intention of the Kennedy Round to make special efforts on behalf of developing countries on a non-reciprocal basis, and in the acknowledgement by the proponents of various plans for establishing free trade areas among advanced industrial countries that such plans must include special provisions for preferred market access to the free trade area for all developing countries or for those in the relevant region. The balance-of-payments difficulties of the United States and the United Kingdom in recent years have had as one consequence the effect of causing these countries to reduce the amount of development aid they have been willing to supply, with inhibitory efforts on increases in the aid supplied by the countries that have been in surplus. The deflation required to underpin the devaluation of sterling, and the new U.S. balance-of-payments programme, will involve both substantial further reductions of the aid supplied by these two countries, and an inability on their part to offer the developing countries any really substantial trade policy concessions at the second United Nations Conference on Trade and Development. This in turn implies an additional moral obligation on the participants in any new regional free trade arrangements to prevent such arrangements from reducing the export opportunities of the developing countries and if possible, to provide expanded export opportunities for these countries.

The implications of the French refusal to allow consideration at present of Britain's application to join the Common Market depend on what steps Britain now decides to take. If, as is present policy, Britain is willing to wait on the doorstep until allowed in on Europe's terms, this would imply a commitment to European regionalism which would preclude a further multilateral approach toward free trade and would strengthen the arguments either for both a Canadian-American and a Japanese-Australian-New Zealand free trade arrangement or for a Pacific Free Trade Area. The same conclusion would follow if Britain and the other members decided to strengthen the European Free Trade Area, possibly by turning it into a Customs Union, in order to discriminate more intensely against the E.E.C. and build up bargaining power for forcing their way into the European Economic Community. If, on the other hand, Britain decided to abandon the effort to get into Europe as either hopeless, or not in her national interest given the present character of the Community, and to look elsewhere for the free competition in a large market she believes the health and growth of her economy require, the stage would be set for serious consideration of a North Atlantic Free Trade Area, which would most probably be more attractive to the United States and Canada than a Pacific Free Trade area - though of course membership in one would not be inconsistent with membership in the other and the two proposals could be combined in an enlarged free trade area scheme.

These preliminary observations are intended to establish a contemporary context for the consideration of alternative trade policy strategies for moving towards free trade in the post-Kennedy Round era. Unfortunately, given the rapidity of developments during the past year, one can have little confidence that further developments will not alter the politic-economic situation and hence the balance of considerations concerning the various alternatives. But it is nevertheless necessary to do the best one can.

For purposes of analysis, the alternative strategies available can be divided into four types, of which the first two entail multilateral negotiations on a non-discriminatory basis (non-discriminatory, that is, on GATT definitions, though not necessarily in economic effect) and the latter two entail negotiations among a restricted group of countries on a discriminatory basis, one type being in contravention of and the other acceptable under the rules of G.A.T.T. These strategies comprise another Kennedy-Round-type GATT negotiation of free trade on a sector-by sector basis; negotiation of tariff reductions on a conditional most-favoured-nation basis; and the formation of free trade areas.

II Multilateral Non-Discriminatory Approaches

(a) A Second Kennedy Round

The success of the Kennedy Round in reducing tariffs on industrial products by an average proportion somewhere in the neighbourhood of one third (as compared with the target of 50 percent) suggests that one possible way of achieving a further freeing of trade would be through a second "Kennedy Round" conducted according to the same ground rules of a targeted percentage linear reducing of tariff rates. The experience of the Kennedy Round itself, however, tends to argue that a second Kennedy Round would be difficult to organize, and unlikely to prove very effective in achieving substantial tariff reductions, at least in the next five years or so.

In the first place, as already mentioned, the Kennedy Round negotiations proved unexpectedly protracted and arduous, and it is unlikely that the major industrial nations would be willing to undertake a similar exercise in the near future - especially as the next time around they would know what to expect, whereas at the outset of the Kennedy Round there was excessive optimism about the speed and efficiency with which negotiations could be completed.

In the second place, while the Kennedy Round was intended to replace the former technique of item-by-item negotiation by negotiation for tariff reductions on a linear basis, in practice the Kennedy Round negotiations relapsed in very short order into something very like the old style of item-by-item negotiation, albeit subject to the overall target reduction, to a deadline for the negotiating process, and to the principle of subsequent tariff reduction according to a fixed time-table. It is probable that in a repeat performance the vested interests in protection in the various countries would be even more successful in asserting themselves so as to corrupt the simplicity of the linear bargaining principle and to make the average tariff reduction actually achieved fall significantly short of the targeted percentage. The history of GATT negotiations, in fact, suggests that a new technique of bargaining for tariff reduction is most successful the first time it is employed--- the first

(Torquay, 1947) GATT negotiations, which introduced multilateral negotiations for the first time on the previously employed item-by-item basis, produced more substantial tariff reductions than the subsequent multilateral item-by-item negotiations under GATT ---- before it has become familiar enough to be exploited by the negotiators to preserve domestic protectionist interests, by offering concessions that do not vitally threaten such interests while withholding concessions that do. If a second Kennedy Round were proposed, the first reactions would probably be an even more acrimonious attack on the linear principle itself than occurred in the early stages of the Kennedy Round, and an attempt to complicate the principle with qualifications for tariff disparities, industries in which there was deemed to be a national interest in domestic production, and so forth; and if it were proceeded with, protectionist interests would be forearmed with knowledge of how to work the bargaining process to defend their interests.

In the third place, and largely in consequence of the preceding two observations, a second Kennedy Round would only be likely to command the interest of the major industrial countries if it could set at least as bold a target as the Kennedy Round itself. The obvious target, and the only one probably capable of generating the necessary enthusiasm and sense of commitment, would be elimination of the tariff barriers on industrial products remaining after the Kennedy Round - "the other fifty percent". (This would of course be only a target, and it would not be expected to reach free trade, only to reduce tariffs as close as possible to the minimum considered essential to overriding national interests or immovable due to the power of vested interests.) The establishment of such a target for a second Kennedy Round would not be feasible until after the tariff reductions of the first Kennedy Round had been absorbed, and public opinion convinced that free trade was mutually beneficial and its disturbing consequences for previously protected domestic industries readily tolerable. This stage might conceivably be reached after the first two or three steps in the time-table of Kennedy Round tariff reductions, but would more likely not be reached until after the full cuts had come into effect five years from now. A further consideration pointing in this direction is the unlikelihood that the United States will be in a position to take the initiative in a major move towards world-wide free trade until its balance-of-payments deficit has been corrected, which event obviously lies several years at least in the future.

For all these reasons, it appears that a continuation of progress towards free trade along the heretofore-established lines of multilateral bargaining in GATT is not a practical possibility; the Kennedy Round seems to represent "the end of the road" for traditional GATT bargaining, at least for a period of years. If further progress towards trade liberalization is to be made in, say, the next five years, it will probably have to be made through the adoption of some new alternative approach.

(b) The Sector-By-Sector Approach[1]

One alternative approach to a second Kennedy Round, which would lend itself to negotiation through the machinery of GATT, is the reduction of tariffs on, or complete freeing of trade in, particular industrial products or product groups, on a non-discriminatory multilateral basis. (This type of sector-by-sector approach has to be distinguished from the sectoral reduction or elimination of tariffs among a group of countries only, such as was involved in the formation of the European Coal and Steel Community, which is discriminatory in GATT terms and requires a GATT waiver.)

The sector-by-sector approach was implicit in the dominant supplier authority of the Trade Expansion Act of 1962, though then the sectors eligible for free trade were to be specified by an automatic rule based on the proportion of free world trade conducted by the major parties to the negotiation, rather than selected by mutual consent of the countries principally concerned in the trade, as under the proposal considered here. The approach was applied, or essayed, in the Kennedy Round itself, in the case of particular difficult industrial sectors; most notably, the liberalization of trade in chemicals was handled by a special agreement embodied in a separate protocol. It has been recommended as a possible basis for future negotiations in the GATT framework by Mr. Eric Wyndham White, Director-General of GATT.

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[1]The discussion of this section draws heavily on G. and V. Curzon, After the Kennedy Round: What Trade Policies Now? (London: The Atlantic Trade Study, 1968).

The industries or industry groups to which the sector-by-sector approach might be effectively applied could be selected according to a variety of criteria. First, an effort might be made to eliminate "nuisance tariffs" - that is, to establish free trade in products where the existing tariffs of the major countries, or a substantial proportion of them, are already low, say 5 percent or less. Second, the "dominant supplier" concept of the Trade Expansion Act of 1962 (and of previous item-by-item bargaining in GATT) might be revived in a suitably amended form. Third, the effort might be made to specify industries or industry groups in which the freeing of trade on a sectoral basis would be likely to be mutually beneficial without imposing serious adjustment problems for the countries involved. Specifically, trade might be freed on a sectoral basis in high-technology research-intensive products, in which tariff protection is relatively ineffective in giving a competitive advantage in the market as compared with technological leadership and innovative capacity. Or it might be freed on a sectoral basis in products which the major countries both export and import on a fairly large scale, so that the adjustment to free trade would mainly involve changes in national product mixes rather than overall changes in national industry sizes. Or trade might be freed in semi-manufactured materials that serve mainly as inputs into other industries.

The sector-by-sector approach would have the advantage of consistency with the GATT principle of non-discrimination, and of considerable flexibility. On the other hand, it would have most of the disadvantages of GATT negotiations prior to the Kennedy Round; that is, there would be urgency about negotiating tariff reductions, and the advance towards free trade could be blocked by the unwillingness of a major industrial country to participate in the negotiations.

Most important, given the urgency of expanding export markets for the manufacturers of the developing countries, even more than the item-by-item approach of GATT bargaining prior to the Kennedy Round the sector-by-sector approach would tend to reduce tariff barriers in a manner that would de facto discriminate against the manufacturing export interests of the developing countries. This would be especially so for the freeing of trade in technologically advanced products, which could benefit the developed countries considerably but would be of little or no help to the developing countries - and could even damage them to the extent that technologically-advanced products such as computers serve as inputs into the efficient production in developed countries of more conventional and standardized products with which the developing countries must compete on the basis of cheaper labour employing a less sophisticated technology. Free trade in products that the developed countries both export and import on a large scale would probably be relatively neutral in its short-run effects on developing country exports, almost by definition, though in the longer run it might well expand the opportunities for developing countries to become themselves exporters of the products in question. The freeing of trade in semi-manufactured inputs might benefit the developing countries considerably, in the sense that such inputs may be characterized by routine production methods suitable for transplantation to developing countries, and may sell on a straight basis of the price charged for a standard product without involving the need to appeal to buyer's tastes or preferences; on the other hand, the availability of cheaper inputs to the developed country producers of the final product outputs would increase the effective rate of protection enjoyed by these producers in their domestic markets against competition from developing country exporters of rival final products.

III Discriminatory Approaches to Trade Liberalization

Given the political fact that the liberalization of trade in the modern world has to be undertaken through international bargaining for reciprocal tariff reduction, the GATT system of regulating barriers to international trade through multilateral agreement and reducing such barriers by multilateral bargaining is a great improvement overthe bilateral methods employeed previously, since it marshalls the superior force of multilateral sanctions to the policing of agreements once arrived at, and permits a sort of "multilateral clearing" as contrasted with "bilateral balancing" of the tariff concessions the separate nations are willing to offer. On the other hand, the multilateral character of GATT tariff bargaining, in conjunction with the principle of non-discrimination between national suppliers of particular imported goods, ensures that progress towards free trade can only be made at the pace which the most timid or reluctant of the major countries participating in the bargaining is prepared to tolerate.

In view of this disadvantage of the GATT machinery, which appeared particularly serious to proponents of freer trade during the long glacial period of the Kennedy Round negotiations before agreement was finally reached, alternative approaches to freer trade have been proposed which would enable those countries most interested in further liberalization of trade to go ahead on their own, on the discriminatory basis of liberalizing trade among themselves without extending the benefits to other countries. These alternatives have been proposed with various motives in mind: sometimes simply to enable the most ardent free-trade countries to set their own pace; sometimes with the objective of forcing the hands of the laggards by establishing superior bargaining power in the form of collective rather than individual national discrimination against them; and sometimes with the hope that the laggards will be, not corrected by discrimination, but won over by the demonstration of the benefits of freer trade to be provided by the new discriminatory trading arrangement.

(a) The Conditional Most-Favoured Nation Approach

As already mentioned, it is a basic principle of GATT that negotiated tariff reductions should be non-discriminatory, that is, that they should be extended to all members of GATT whether or not they have reciprocated those reductions by reductions of their own tariffs; and it is this principle that confines the pace of trade liberalization to the pace tolerable to the participating countries least enthusiastic about trade liberalization. To circumvent this drawback of the GATT apparatus for trade liberalization, it has been suggested that the countries most anxious to liberalize trade - and specifically the United States - should in their international bargaining revert to a technique employed in the past, that of conditional most-favoured nations treatment, under which tariff reductions arrived at by bilateral or multilateral bargaining would be available to other nations not party to the original bargaining only on condition that they offered equivalent reductions of their own tariffs.

This proposal was made by various experts and politicians prior to and in the middle stages of the Kennedy Round, when it was thought that the Common Market countries would refuse to bargain for tariff reductions within GATT; and it was also considered by various Kennedy Round negotiators as a means of countering the propensity of Australia, Canada, Japan and New Zealand to attempt to enjoy a "free ride" on the tariff reductions being negotiated among the U.S., U.K., and E.E.C. without offering tariff reductions of their own in reciprocation.[1] It obviously has certain attractions as a technique by which a group of like-minded countries bent on trade liberalization could press ahead, especially if their long-range aim were to build up their bargaining power against the group of laggard countries in the hope of coercing the latter into being willing to negotiate free trade on a multilateral basis.

The conditional most-favoured-nation principle was the basis of United States tariff policy until 1923; and it is relevant that it was abandoned because of the serious difficulties encountered in operating a tariff policy on that principle. Strongly against reversion to it is the consideration that, since unconditional most-favoured nation treatment is the basic principle of GATT, a GATT waiver requiring a unanimous vote would be necessary if reversion were to be made consistent with the preservation of the GATT machinery and the GATT structure of tariff agreements and code of good commercial policy behaviour. Apart from that problem, which could presumably be overcome if the countries involved were important enough in world trade and could make out a plausible enough case that what they proposed to do was consistent with the free-trade spirit of GATT, there is the more general question whether it is worth bringing the principle of non-discrimination into jeopardy, whatever the provocation offered at particular points of time by the obstinate refusal of important countries to co-operate in the liberalization of trade. The principle of non-discrimination, embodied in the unconditional most-favoured-nation provision, does establish a rule of law in international commercial diplomacy, whereas, as both past history and general reasoning show, the conditional most-favoured-nation approach can only too easily degenerate into the law of the jungle. The principle of non-discrimination as implemented and applied through GATT has on the whole and in the long haul worked well, and there is every reason not to subvert it for the sake of a temporary acceleration of the pace of trade liberalization. This conclusion is especially cogent as there exists within the framework of GATT, and quite consistently with its principles, an alternative means by which countries desirous of forcing the pace of trade liberalization can do so by establishing freer trading arrangements among themselves discriminatory against third parties - the exemption from the general GATT ban on new preferential arrangements of custom

(1) See Curzon and Curzon, op.ut. pp. 32-34

unions and free trade areas covering "substantially all trade" among the participating countries and scheduled to come into full effect within a definite period of time.

(b) The Free Trade Area Approach

The exemption of customs unions and free trade areas from the general enjoinment on new preferential arrangements, provided that they cover "substantially all trade" among the members, rests on the assumption that such trading arrangements represent on balance a movement towards freer world trade. That assumption is extremely questionable as a general presumption, from the theoretical point of view, but the central point is that such arrangements are sanctioned by international agreement as a legitimate means of moving towards free trade. Moreover, while the phrasing requires the inclusion of "substantially all trade", recognition of the special position and problems of agriculture has meant that in practice what is required to qualify for approval is free trade in in substantially all industrial products.

The two alternative forms of discriminatory trading arrangement deemed consistent with the general principle of non-discrimination are, however, sharply divergent in their implications. The customs union requires unification of external tariffs, which in turn presumes a common political will and implies the creation of at least a "pseudo-nation" out of the member nations for the purpose of commercial policy with respect to the outside world, whereas the free trade area provides only for free trade with other members, and allows members to retain their national sovereignty with respect to commercial relations with the outside world. Thus the relative emphasis of a customs union is on joint discrimination by members against trade with non-members, whereas the relative emphasis of a free trade area is on the freeing of trade between members; and the customs union makes it relatively difficult, whereas the free trade area makes it relative easy, to admit new members from the outside world. The customs union, in other words, is primarily a means of extending the scope of national tariff protection, whereas the free trade area is primarily a means of extending free domestic competition beyond national boundaries. (This distinction is of course too black-and-white, because both types of arrangement have both types of effect; but it seems valid as a broad generalization). It follows that the free trade area is the natural arrangement for a group of countries that wish to accelerate progress towards world free trade in the face of reluctance on the part of others to adopt. This is the motivation of most of the proponents of a North Atlantic Free Trade Area, and presumably the motivation of the proponents - or at least of many of them - of a Pacific Free Trade Area. However, a free trade area is also an attractive arrangement for a group of countries in a region that would like to exploit the development potentialities of the region on the basis of regional protection, but by reason of political, economic, and cultural diversity could not contemplate formation of a customs union. This has been the motivation of some proponents of free trade between Canada and the United States, and is presumably the motivation of some proponents of free trade among Australia, New Zealand and Japan.

Apart from the fact that a free trade area constitutes a legitimate method, within the framework of GATT, of accelerating progress towards free trade by by-passing countries reluctant to co-operate in making such progress, the free trade method has the substantive advantage over bargaining for tariff reductions multilaterally in GATT that it promises to arrive at complete free trade, albeit only with other member countries, within a finite and predictable period of time. This is a matter of considerable importance to the smaller and less mature industrial countries that might participate in such an arrangement, since the main gains that such countries may expect to obtain from trade liberalization lie in the opportunities for specialization, and the associated economies of scale and profitability of research and development expenditure, that free trade and the guarantee of assured access to a large market, but not low tariffs and changeable foreign commercial policies, can provide.

By contrast to the multilateral non-discriminatory approach to trade liberalization discussed in the preceding section, also, the free trade area alternative (and for that matter the formation of customs unions) provides the institutional opportunity to make special arrangements to expand export opportunities for the developing countries, either for the collectivity of them or for those in the region on which the free trade area is formed. As mentioned in the introductory section, the effort to improve the export opportunities of the developing countries through the machinery of GATT has had rather disappointing results, the multilateral context of negotiation apparently providing insufficient stimulus for the exercise of generosity by the developed towards the developing countries. On the other hand, action by individual developed nations is inhibited both by the general aversion to showing more generosity than others, and by the concrete fear that such excessive generosity would lead to undue disruption of domestic markets. The free trade area offers in this connection a convenient half-way house: as an association of like-minded nations it is more likely than the aggregate of the Contracting Parties to GATT to be able to form a concensus on appropriate trade policies for assisting the developing countries - especially if it assumes specific responsibility for developing countries in its own region - while at the same time being able to arrange for the burden of adjustment to expanded imports from the developing nations to be fairly shared among its members.

IV The Position of the Pacific and Asian Regions

The evolution of international commercial policy since the Second World War has been dominated by relations within the North Atlantic Region between the United States on the one side and the European countries on the other, relations strongly conditioned in the immediate postwar period by the "cold war" between the United States and Russia. In the course of the postwar period, U.S. foreign economic policy has turned from the pursuit of the pre-war objective of multilateral non-discriminatory reduction of tariff barriers to the promotion of European economic integration, and then back to the non-discriminatory liberalization of world trade as a means of containing the regionalizing and discriminatory forces it had turned loose in Europe. The conclusion of the Kennedy Round marks the achievement of only partial success in this last endeavour. This paper has surveyed the alternative strategies available for pursuing the ultimate objective of free world trade in the post-Kennedy Round era. In so doing, it has maintained the conventional focus of trade policy discussion on the Atlantic Region, on the traditional assumption that world trade policy is appropriately discussed in that context.

The configuration of world trade has been changing, however, with the rise of the Pacific Region, which overlaps the North Atlantic region through the inclusion in both of the United States and Canada. The political environment of international commercial diplomacy has also been changing, with the achievement of a detente between the United States and the Soviet Union and the emergence of Communist China as a rival super-power. It is necessary, therefore, to consider briefly the position of the Pacific and Asian Regions, and particularly the part that the advanced industrial countries of the Pacific might play in the evolution of a new world trade policy in the post-Kennedy Round era.

While the relative importance of the Pacific Region in world trade has been increasing, and while one can forecast a growing role of Asia in international commerce, the Atlantic Region will remain for a long time ahead the focus of world trade strategy. This implies that the proposal for a Pacific Free Trade Area (to include the U.S.A. and Canada as well as Australia, Japan and New Zealand) cannot be a proposal for near-term action, but must be at best a long-range project. As such, its relevance and feasibility will depend on three factors: the evolution of the importance in world trade and the patterns of trading interests of the prospective partners, the development of Communist China as a political and economic power in the world, and the development of trading relationships in the Atlantic Region. As suggested in earlier sections, the proposal would be most likely to become practically relevant if on the one hand Britain and the other EFTA countries gained admission to a European Common Market that remained protectionist and inward-looking, and attempted to build itself up as a super-power rival to the United States and the Soviet Union, while on the other hand the United States became concerned to strengthen the economies of the non-Communist countries of the Pacific against the threat of aggression from Communist China, as earlier she was concerned to strengthen the economies of Europe against the threat of Communist agression from Russia. If, to the contrary, the EFTA countries succeeded in entering a Europe which thereafter became outward-looking and interested in further trade liberalization, free trade in the Pacific would be subordinated to free trade for the world as a whole as an objective; and if Britain decided to write off her bid to join the Common Market as a failure, and turn westward across the Atlantic in her trade policy, Pacific free trade would be a sequel and extension or adjunct of Atlantic free trade.

Since the likely course of future events is unpredictable, the proposal for a Pacific Free Trade Area is nevertheless well worth exploring, especially as a Pacific Free Trade Area would not be inconsistent with an Atlantic Free Trade area; rather, the two would be complementary instrumentalities of advance towards the ultimate objective of world free trade. Moreover, publicity for the benefits of free trade, whatever the form proposed for it, will be salutary in a post-Kennedy Round era in which the forces of protectionism threaten to gather strength; and the results of research on the probable effects of a Pacific Free Trade Area will be useful for the determination of future trade policy, whether or not the actual outcome is a Pacific free trade arrangement. Finally, exploration in the context of the Pacific Free Trade Area proposal of measures that might be taken to expand the export markets of the developing countries will be independently useful in helping to solve one of the most important outstanding problems of world trade policy in the post-Kennedy Round era.

For the nearer term, it would seem more realistic to concentrate attention on the probable benefits, drawbacks, and constitutional problems of a narrower Pacific free trade arrangement among Australia, New Zealand, and Japan. There is no reason why the exploration, and the formation, of regional arrangements for freer trade should wait on the determination of a global world trade strategy; and, as outlined above, there are various reasons why a regional free trade arrangement may be more attractive to relatively small, not yet fully mature industrial economies than the gradual negotiation of successive reductions of existing tariffs that has been pursued by the larger and more mature industrial nations through the agency of GATT. A free trade area among these three countries could in addition - like EFTA in the European context --- serve as a pilot model of free trade for the rest of the world, and possibly in the course of time be one of the building blocks out of which a world-wide system of free trade could be constructed.

Chapter 8 THE AGRICULTURAL GAP IN THE PACIFIC[1]

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I Background

The European Economic Community, which is the most important trading area of agricultural commodities in the world, launched a Common Agricultural production and trade in the community are effectively integrated by this policy, which is, the author thinks, quite protective. The second biggest trading area of agricultural commodities in the world is the Pacific Basin. The four biggest exporters of agricultural commodities in the world, i.e., Australia, Canada, New Zealand and the United States, and Japan, one of the world's biggest importers of agricultural commodities, all face to the Pacific Basin. Asia and the Far East, which is also a big importer of agricultural commodities, gets a large part of its agricultural import requirements via the Pacific routes. Therefore, the Pacific Basin is the most important unintegrated trading area of agricultural commodities in the world and is extremely important in promoting the stability and orderly expansion of world trade in agricultural commodities.

Nowadays almost all developed countries are protecting their domestic agriculture, and the world trade in agricultural commodities is far from free. However, it is without question that a country whose agricultural economy depends heavily on exports can not pursue its agricultural progress independently of the world market. Agricultural resources in the four exporting countries of the Pacific Basin are too abundant to permit them to pursue their agricultural program independently of the world market. Moreover, they are all temperate zone producers, and producing and exporting the same kinds of commodities. On the other hand, Japan, which is protecting its domestic agriculture very strictly, depends heavily on these major exporters for food and agricultural raw materials

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[1]The author is extremely grateful for the comments offered at the conference, especially for the one by Professor Sir John G. Crawford, the Australian National University.

since its agricultural resources are too poor to supply its population with sufficient food and fibre. Joint action of the five developed Pacific countries in the field of agricultural trade could be very effective not only in promoting the stability and orderly expansion of Pacific trade in agricultural commodities, but also in setting up successful domestic agricultural programs. The first step in this direction will be taken at the end of January 1968, when five Pacific members of the International Federation of Agricultural Producers meet in Honolulu to discuss various aspects of the Pacific trade in agricultural commodities, including food problems in developing countries. We hope that the Honolulu conference is successful and is followed by more powerful action.

On the western side of the Pacific Basin there are the developing countries of Asia and the Far East. As noted earlier, these countries are, as a group, big importers of agricultural commodities, although their main export items are also agricultural commodities. The average per capita calorie intake of this area in 1962 was 2,080 calories, which was only 93 percent of the calorie requirement of the area.[1] This was the lowest figure in the world. The countries in the area are mainly agricultural. Agricultural productivity in these countries is very low and will be a bottleneck to their economic development. Therefore, transforming the traditional agricultural methods into modern ones is of vital importance to attain not only a high nutritional level, but also rapid economic development in these countries. As will be noted later, there is a big gap in agricultural productivity between these developing countries and the developed Pacific countries. The agricultural resources and scientific knowledge accumulated in the latter can be used in transforming agriculture in the former. Joint action of the five Pacific countries in this field will be very helpful too.

The purpose of this paper is to explain the necessity and efficacy of joint action in these two fields of agriculture among the five Pacific countries and to show a feasible way to coordinate it.

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[1]Food and Agriculture Organization of the United Nations, <u>Agricultural Commodities -- Projections for 1975 and 1985</u>, 1967, Vol. 1, pp. 36-37.

II The Outlook for Trade in Agricultural Commodity in the Area in 1975.

In this section basic data for explaining the need and feasibility of Pacific agricultural integration is presented. It is a survey of the demand for and supply of various agricultural commodities at present and in 1975. The survey is quite selective, and only important trading items in the area are included.

Another kind of basic data for the same purpose may be the estimated effect of the reduction of tariff and non-tariff barriers on trade of the commodities in the area. However, lessons from the Kennedy Round discussions show that any further significant lowering of levels of agricultural protection in either the United States or Japan is not immediately practicable[1]. The binding of montante de soutien (fixing levels of protection), arrangements for ratios of self-sufficiency,[2] and other measures will be more practical. The author does not estimate any effect of reduction of tariff and non-tariff barriers on trade of the commodities in the area.

Fortunately an extremely comprehensive study of agricultural commodity projections for 1975 and 1985 by the Food and Agriculture Organization of the United Nations was published recently.[3] The summary of results is included with the author's own estimates in the appendix tables at the end of this paper. Highlights in the summary are as follows.

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[1] After receiving the comments by Professor Crawford the author feels that the latter part of this sentence should be replaced by the following one. "...any further significant lowering of levels of agricultural protection in either the United States or Japan is not immediately practicable."

[2] The ideas of montante de soutien and of arranging ratios of self-succiency were proposed by the European Economic Community in the Kennedy Round negotiations as parts of an idea for market organizing world trade in agricultural commodities. For details of this idea, see Yves Malgrain, L'Integration Agricole de L'Europe des Six, 1965, esp. Part Three and J.H. Richter, Agricultural Protection and Trade: Proposals for International Policy, 1964, Chap. II.

[3] Food and Agriculture Organization of the United Nations, Agricultural Commodities-Projections for 1975 and 1985, 1967, 2 vols. the author owes heavily to Mr.Yonosuke Hara for his statistical work in checking the FAO figures.

Wheat   Exportable surpluses of wheat will increase significantly in the United States and Canada, and also increase in Australia. Japanese import requirements will increase considerably, while those of New Zealand will decrease. The net exportable surplus of the developed Pacific countries will increase significantly. The import requirements of Southern and Western Europe will decrease drastically, and, the Pacific wheat exporters will find it very difficult to find an export market for their wheat. The exportable surplus of these countries will be far bigger than the total import requirements of the developing countries, including the countries of Asia and the Far East. Therefore, an arrangement for production control among the developed Pacific countries will be worthy of consideration, and there will be a possibility of including a food aid program in the arrangement.

Coarse grains   Among the Pacific exporters only the United States will increase its exportable surplus of coarse grain considerably. However, the amount of the projected increase is almost equal to the projected amount of increase in Japanese import requirements. Thailand will also increase its exportable surplus. However, other Asian countries, such as India, will increase their import requirements too. Moreover, the projected world production is almost in balance with the projected world consumption. There will be no serious problem in coarse grain trade in 1975.

Rice   Rice is, and will be far more important in agricultural production and food consumption in Asia and the Far East. During 1961-1963 Asia and the Far East exported rice in small amounts to the outside world. However, under a low GDP assumption, there is a possibility of a rice deficiency in the area, though the projected deficient amount will not be large and can be met by the projected exportable surplus of the developed Pacific countries. Therefore, there will be no serious shortage in the rice trade in 1975 except for the problem of foreign exchange needed for the developing Asian importers to buy rice. Under a high GDP assumption, projected world production will exceed the projected world consumption by about 6 million tons. When this situation is realized, Asian rice exporters will face serious difficulty in finding export markets. Moreover, the projected wheat surplus of the world is far bigger under a high GDP assumption than under a low GDF assumption.

Although there are many publications and speeches which warn the world of a serious food shortage in the not very distant future, the fact is that, as far as the grain economy is concerned, there will be no serious shortage, but a possibility of having a serious surplus in the world, particularly in the Pacific-Asia area, by around 1975. The other fact to be noted is that the approximate self-sufficiency in rice of India, Pakistan and some other countries is dependent upon large amounts of wheat imported partly as a substitute for rice. A considerable part of these wheat imports has been on concessional terms. Therefore, in any consideration of arrangement of wheat trade among the developed Pacific countries mentioned above, not only coarse grains, but also rice should be included.

Milk and milk products These products are produced and consumed mainly in developed and centrally planned countries, and not in developing countries. There will be three noteworthy tendencies in production and trade among the developed countries. First, the European Economic Community will experience a tremendous increase in its exportable surplus, and will export the equivalent of 8 million tons of milk in milk products in 1975, which will be slightly less than the projected combined exportable surplus of Australia and New Zealand. Of course, both Australia and New Zealand will increase their exportable surpluses considerably. Second, Japan will increase its import requirement significantly. Third, both the United States and Canada will not increase their exportable surpluses.[1] The developing countries, especially developing Asian countries, will become influential figures in the world trade in milk products. These countries will increase their import requirement tremendously. The output of milk in these countries scarcely kept pace during the past decade with the increase in consumption due to increases in both population and per capita consumption, and this tendency will continue in the future.

In summary, there will be two big problems in this group of commodities. First, both Australia and New Zealand will

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[1] Recent developments in the dairy industry in the United States shows that there is a possibility of the United States becoming a net importer in the near future.

face a grave difficulty in finding cash markets for their products in the developed countries.[1] Second, how to supply the population of Asia and the Far East with sufficient and cheap milk and milk products will be a serious problem not only in these developing countries, but also in the developed Pacific countries. We have to be prepared to face these problems.

Meat A table for meat is not included in the appendix, because tendencies in the world meat market resemble the tendencies in the world milk and milk products market except for the following facts. First, the European Economic Community will continue to be a big importer of meat. Second, the developed countries as a whole will continue to be big importers of meat. These two tendencies are especially true in the case of beef and veal. There will be no serious problem for Australia and New Zealand in finding a cash market for meat. The only problem foreseen in the future is how to supply the Asian population with sufficient and cheap meat. The output of poultry and pork can be expanded rapidly, and the feed conversion ratio which can be obtained is relatively high. The problem of supplying the Asian population with meat will not be as serious as that of milk and milk products.

Sugar The future of the world sugar market is quite uncertain, since the futures of both centrally planned countries and Latin American countries, mainly Cuba, are quite uncertain. However, the developing Asian countries will continue to be exporters of sugar, and so will be Australia, although Australian exports of sugar will increase more rapidly than those of the other Pacific-Asia exporters. The United States imports will not increase significantly. Japan and Canada will increase their import requirements considerably, and the combined volume of increase in imports projected is about equal to the combined volume of projected increase in the exportable surplus of Oceania. Therefore, it can be concluded that, if the developed Pacific and developing Asian countries agree about arranging the sugar trade in the Pacific-Asia area, the arrangement will be quite helpful in stablizing and expanding the sugar trade in the area.[2]

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[1] If the United Kingdom succeed in joining in the European Economic Community, the difficulty of Australia and New Zealand will be extremely serious.

[2] It is to be noted that the International Sugar Agreement has not been working recently.

Fats and oils Fats and oils consist of five groups of commodities; i) by-products such as cottonseed oil, fish oil, etc.; ii) tree crops such as palm oil, olive oil, etc.; iii) annual crops such as groundnut oil, rapeseed oil, etc.; iv) butter and v) whale oil. The production and consumption of fats and oils is extremely complex, and the supply of and demand for some items of fats and oils are fairly elastic with respect to price changes in these commodities. Production can easily balance consumption, especially in developed countries. The biggest problem of the Pacific exporters will be to find markets for their products in the centrally planned economies. Only in some Asian countries, India and Pakistan, will the shortage in fats and oils worsen. The fat and oil problem in Asian and the Far East as a whole is the projected decrease in exportable surpluses in the area. The future of fats and oils will be similar to that of milk and milk products.

Tea The main producers in the world are India and Ceylon. They will increase their exports of tea tremendously. The problem of tea is exclusively one of assuring a market for them.

Cotton There are two problems in cotton. The first is the problem of shifting cotton manufacturing from the developed to the developing countries. Considerable expansion can be anticipated in the textile export capacities of India, Pakistan, Hong Kong and a number of smaller developing countries. Net imports of cotton manufactures into other developing countries may be reduced. On the other hand, imports into developed countries of cotton goods will increase, and Japanese exports may decline. The future of the developing cottom manufacturing countries will depend on their capacity to reduce the cost of manufacturing and to improve the quality of the goods. The second problem is that cotton is keenly competing with man-made fibers. The future of cotton producers will continue to depend upon their capacity to reduce the costs of production and to improve quality.

The survey above of the demand for and supply of various agricultural commodities in the area shows that there will be no serious food shortage in the area. In the cases of some quality foods, such as milk and milk products, how to overcome the projected shortage will be a real problem, and in some countries, such as India and Pakistan, there will be a continuous necessity of increasing food production, since these countries will continue to have a shortage of foreign exchange. Generally speaking, a mere increase in production of a commodity in some importing countries will have an adverse effect on exporters of the same commodity. Measures for stabilizing and expanding trade in agricultural commodities in such a situation will be discussed in the next section.

Before discussing measures, we have to make clear a deep rooted problem in Asian agriculture. As noted earlier, imports of rice into Asian rice eating countries have been kept at low level by high level imports of wheat in postwar days. For example, rice imports of the rice eating Asian countries (Ceylon, India, Indonesia, Pakistan, Hong Kong, Japan, Korea and Taiwan) totalled about 5 million tons annually during 1934-38, and it was 3.4 million tons annually during 1957-59. Wheat imports in the same area totalled 0.3 million tons annually during 1934-38 and 7.4 million tons annually during 1957-59. The percentage of the total wheat imports of wheat that was bought on special terms during the latter period were only 51-62%.[1] It is clear that Asian rice exporters are losing their competitive position in world grain trade.

Long-run price movements for rice show the same fact. Table 1 shows that the rice price did not show any tendency of decline while the wheat price did. (The rice price during 1950-52 was exceptionally high because of the Korean War.) The same tendency could be seen in the British market since 1867-77. The price of Burmese rice at British ports of import declined only 7 percent during the period from 1867-77 (average) to 1931-39 (average), while the American wheat price in the same places declined about 42 percent during the same period.[2] There has been a widening productivity gap between the developed Pacific wheat production and the developing Asian rice production.

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[1]See Food and Agriculture Organization of the United Nations, The World Rice Economy, Vol. II: Trends and Forces, 1963, p. 95.

[2]V. D. Wickizer and M. K. Bennett, The Rice Economy of Monsoon Asia, 1941, p. 137

Table 1. Changes in World Market Price of Rice and Wheat (1934-38 = 100)

	1924-28	1950-52	1959-61
Rice	321	490	359
Wheat	270	239	200

Source: United Nations, Commodity Survey 1962, 1963, p. 19.

Rice represents Asian agriculture while wheat represents western agriculture. Agriculture is the most important economic sector amoung the developing Asian countries. Moreover, rice was, and is a basic wage good in Asia and the Far East, while grain and animals fed on grain were, and are, basic wage goods in western countries. Therefore, it can be said that the Ricardian case of a falling rate of profit and vanishing investment opportunities is working in the developing Asian countries. Cheap food is much important than self-sufficiency in food among the developing Asian countries. As Thorkil Kristensen, Secretary-General of OECD, stated, some of them would do better to continue to be large net importers of food for a long period to come, and to become rather large exporters of manufactured goods.[1]

III Possible Arrangements for Stabilizing and Expanding Pacific Trade in Agricultural Commodities.

We have three kinds of experiences in controlling trade in agricultural commodities in postwar days. These are experiences in international commodity agreements, in the disposal of surplus agricultural products or food aid, and in the Kennedy Round negotiation.

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[1]Thorkil Kristensen, "The Economist and Farm People in a Rapidly Changing World", in International Journal of Agrarian Affairs, May 1967, pp. 151-55.

Postwar experiences of international commodity agreements have, generally speaking, been disappointing.[1] The reasons for this disappointment are as follows. First, the agreements have had nothing to do directly with the long-run tendencies of the commodity exports from developing countries. Second, a far smaller number of agreements were concluded than was expected in the immediate postwar period. Third, these agreements have been too timid in asking modifications in the domestic commodity policies of participating countries. These reasons have to be taken into consideration in formulating possible arrangements.

Experiences in surplus disposal or food aid have been fairly successful, partly due to the excellent principles of surplus disposal recommended by FAO and agreed upon by almost all developed countries.[2] But the main reasons for success are the persistent food and foreign exchange shortage of a number of developing countries, and the ability of the United States to export the commodities on concessional terms. It is, of course, true that food aid is a special kind of tied aid, and has some of the common drawbacks of tied aid. Moreover, surplus stocks of grains have diminished in recent years, and after the large sales to India in 1965-6, they no longer exist. As was stated in the last section, to meet the needs of the recipient developing countries, milk and milk products and some other non-cereal foods will have to be included as food aid commodities in the future. Therefore, food aid has to come out of current production in the future, and it will be a heavier burden to donor countries than when it was taken out of stocks already accumulated in order to support domestic agriculture. These facts have to be taken into consideration in the formulation, too.

Before discussing the Kennedy Round negotiations,

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[1] See Kenzo Hemmi, "International Commodity Problems," in Measures for Trade Expansion of Developing Countries: Report of a Japan Economic Research Center International Conference, 1966, pp. 223-24.

[2] See, Food and Agriculture Organization of the United Nations, Functions of A World Food Reserve: Scope and Limitations, 1956, pp. 75-77.

some facts in the history of the General Agreement on Tariffs and Trade need to be noted.[1] First, as early as 1954-55, the United States expressed the intention of continuing import restrictions on milk products on which there were no domestic restrictions. Since then milk products have continued to be the subject of the most heated debates in GATT discussions. New Zealand is among the claimants, and the United States is among the defenders. A Special Group on Dairy Products which was formed as a part of the Dillon Round settlement has not worked at all. Second, mainly as a result of the Haberler Report, it has been increasingly realized that the tariff is only one of many devices for agricultural protection. It was estimated that, of the production in the thirty-four countries investigated, non-tariff measures covered the trade of

84% of all butter production,[2]
59% of all cheese production,
52% of all sugar production,
87% of all wheat production.

These non-tariff measures include not only quantitative restrictions, but also import levies, state trading measures, bilateral agreements, etc. Finally, overlapping with this fact, it has been increasingly realized that different principles have to be applied to trade in agricultural commodities than those applied to trade in manufactured commodities. The Groups on Cereals, Meats and Dairy Products, all of which were formed at the same time, were a response to this realization. The Baumgartner Proposals for organizing world trade in agricultural commodities also arose from such a realization.

The experiences of the Kennedy Round negotiations generally resemble those above listed. First, the resulting tariff cuts in agricultural commodities are less remarkable than those in manufactured commodities, and it is generally

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[1]See Gerard Curson, Multilateral Commercial Diplomacy; The General Agreement on Tariffs and Trade and its Impact on National Commercial Policies and Techniques, 1965, chapter VII.

[2]Op. cit., p. 192.

believed that there will be no significant tariff cuts in agricultural commodities in the near future. Second, among the concessions in the GATT negotiations, a proposal for having agreements to keep the self-sufficiency ratio below a declared percentage was outstanding. Since the difficulty of removing agricultural protection in developed countries is already generally recognized, and since the fact that protection, in turn, stimulates technical progress is also generally recognized, assurances not to increase the self-sufficiency ratio may be a practical type of concession. Third, a proposal to bind the montante de soutien as an element of concession was proposed, though it did not receive so much attention as the notion of the assurance. These three experiences show that any further significant reduction in levels of agricultural protection is not immediately practicable. However, in developed countries, the volume of import, or export of some agricultural commodities, such as milk and milk products, is small in relation to domestic consumption or domestic production. Therefore, the net imports of developed countries could be very sensitive to moderately small changes in domestic agricultural and food policies.[1] In the case of Japan, even the fixing of the level of protection will be effective in expanding imports of agricultural commodities. Fourth, an International Grain Agreement arrived at during the Kennedy Round negotiations reflected the opinion that food aid has to come out of current production in the future, and provisions for sharing the burden of food aid were included in the agreement. As was noted in the previous section, future needs for food aid will be not only grains (including rice), but also for such commodities as milk and milk products. Both Australia and New Zealand, which are the main exporters of milk products, can not bear the whole burden of such kinds of food aid as milk products. It will be necessary to provide for sharing the costs of food aid in the Pacific Basin. The author expects that, except for India, the future demand for food aid in Asia and the Far East will not be unbearably large.

One additional fact can be mentioned. Australia and Canada have exported a huge amount of wheat to the centrally planned countries since 1963. Wheat exports to these countries of two Pacific wheat exporters have been a real headache

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[1]See appendix tables. This fact is noticed in the Haberler Report. See General Agreement on Tariffs and Trade, Trends in International Trade: A Report by a Panel of Experts, 1958, p. 89.

to American wheat growers. However, the future import requirements for wheat of the centrally planned economies will not be large; they may have a exportable surplus in the future.[1] All three grain growers in the Pacific Basin will face a wheat surplus problem.

Arrangements for stabilizing and expanding Pacific trade in agricultural commodities should be based on the above experiences.

There will be four types of arrangements; arrangements for trade liberalization, arrangements concerning market access for exporters, arrangements for sharing the costs of food aid, and arrangements for assisting agricultural development in developing Asian countries. The first two types are commodity arrangements, and remaining two are non-commodity arrangements.

The trade liberalization arrangements will be modest. Any significant tariff cut or any significant reduction of the level of agricultural protection is not practical.[2] Moderate changes in agricultural and food policies, or fixing of producers' real prices of agricultural commodities both in exporting and importing countries, are much more practical. The market access arrangements are of two kinds; arrangements of self-sufficiency ratios and the coordination of individual long-term bilateral contracts. There will be no arrangements for international commodity price stabilization, since stabilization is a main objective of traditional international commodity agreements.

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[1]The author has no information about Communist China's future import requirements. About Soviet Russia, see Bureau of Agricultural Economics (Canberra, Australia), The Economics of the Soviet Wheat Industry, December 1966.

[2]After receiving the comments by Professor Crawford the author feels that these two sentences should be replaced by the following three sentences. "The commodity arrangements which are proposed here should be taken as the first step in a series of trade liberalization movements in the Pacific basin. The trade liberalization arrangements will be modest. Any significant tariff cut or any significant reduction of the level of agricultural protection is not practical in the immediate future."

Arrangements for sharing food aid costs are of two types; those for individual countries such as India, Pakistan, etc.; and those for an emergent food shortage such as in the case of a very bad crop. As was already noted, increasing self-sufficiency in food is not always practical and economical, and sometimes it is very harmful to food exporters. Therefore, the arrangements for sharing food aid costs are very helpful in preventing countries from launching uneconomic programs to increase food production.

The agricultural development assistance arrangements are quite different. Since the developing Asian countries are generally agricultural, and since Asian agriculture is generally quite traditional, transformation of the traditional agriculture should be one of the first steps in their economic development. Supplying capital and dispensing technical knowledge in the developed Pacific countries will be the main parts of the assistance. However, the modernization of traditional agricultural supply and processing industries in the developing Asian countries is very effective in helping to transform the traditional agriculture. The promotion of direct joint investment in these fields in these countries is also a part of the assistance arrangement.[1]

The author will not go into the details of these arrangements, since they are quite technical. Only several points are explained. First, the trade liberalization arrangements are made only by the developed Pacific countries. Second, the market access arrangements are made by the developed Pacific and developing Asian countries. The arrangements concerning the self-sufficiency ratio are made mainly by the developed Pacific countries and will take the form of allocating import quotas to the Pacific exporters. Third, balancing the costs and benefits incurred by these four arrangements among the developed Pacific countries, is the most crucial factor in carrying out Pacific agricultural integration. The au-

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[1]The role that the modernization of agricultural supply and processing industries plays in transforming the traditional agriculture has been unbelievably neglected until recently.

thor is not very pessimistic about solving this crucial problem, since imbalance in the trade arrangements can be balanced by cost sharing in the aid arrangements. Moreover, Japan, which will be the loser in the trade arrangement, will a big beneficiary of the anticipated liberalization of trade in manufacturing commodities.[1] The author proposes the establishment of a Special Committee on Agricultural Development in the Organization for Pacific Trade and Development which is proposed in Prof. Kojima's paper.

For the main features of the individual commodity arrangements see Appendix.

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[1]See K. Kojima, "Japan's Interests in the Pacific Trade Expansion", in this volume.

APPENDIX: MAIN FEATURES OF THE INDIVIDUAL COMMODITY ARRANGEMENTS

Grain Arrangement - Wheat, Coarse Grains and Rice

i) Acreage allocation among the developed Pacific countries, and fixation of levels of protection among the developed Pacific countries.

ii) Offering of the amounts of grain required by the food aid arrangement.

iii) Joint operation of a grain bufferstock by the Pacific-Asian countries.

Milk Products Arrangement

i) Modest reduction or fixation of levels of protection among the developed Pacific countries.

ii) Offering of the amounts of milk products required by the food aid arrangement.

Meat Arrangement and Cotton Arranement

i) Coordination of long-term contracts.

Sugar Arrangement and Tea Arrangement

i) Allocation of import and export quotas among the Pacific-Asian countries.

Appendix Table 1. Wheat; Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Million tons)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	105.6	-14.2	143.1	-38.3	143.2	-39.1
E.E.C.	27.0	1.2	35.0	-3.1	35.0	-3.5
U.S.A.	31.5	-19.8	44.7	-23.5	44.7	-23.3
Canada	14.3	-11.3	18.8	-14.1	18.8	-14.0
Japan	4.3	3.0	6.6	5.5	7.1	6.0
Australia	8.0	-6.0	10.2	-7.7	10.2	-7.7
New Zealand	0.4	0.2	0.5	0.1	0.5	0.1
Centrally Planned Countries	91.8	9.3	113.1	5.8	114.2	-0.9
Developing Countries	50.3	14.2	74.8	21.7	77.7	8.1
Asia and Far East	22.6	7.3	35.0	12.8	36.6	4.1
India	14.6	3.7	23.1	6.7	24.2	0.2
Pakistan	5.3	1.4	7.8	2.4	8.2	.0.2
Taiwan	(0.3)	(0.2)	(0.4)	(0.3)	(0.4)	(0.3)
Korea	(0.1)	(-0.1)	(0.8)	(0.6)	(0.9)	(0.6)
Burma	(0.1)	(-0.1)	(0.1)	(0.1)	(0.1)	(0.1)
World Total	228.8	0.7	303.5	-10.8	326.7	-31.6

Notes 1) All figures are from Food and Agriculture Organization of the United Nations, Agricultural Commodities-Projections for 1975 and 1985, 1967, except for those figures in parentheses which are projected by the author.

2) Those figures which are underlined are not of production, but of consumption.

3) Under the low G.D.P. assumption growth rates of developed, centrally planned, and developing countries are 3.5, 4.6 and 3.6 percent per year compound. Under the high G.D.P. assumption these figures are 4.8, 6.0 and 3.5 percent per year compound. For the details of projections, see FAO, op. cit.

4) Unless otherwise stated, these footnote apply to other appendix tables.

5) In this Wheat-table, Thailand is excluded from Asia and Far East.

Appendix Table 2. Coarse Grains; Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Million tons)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	230.1	2.2	313.0	4.8	322.2	12.1
E.E.C.	38.8	9.6	52.9	11.7	55.4	14.2
U.S.A.	133.9	-14.9	184.5	-20.7	184.5	-17.9
Canada	12.3	-0.3	16.8	-0.7	16.8	-0.2
Japan	4.6	2.6	10.5	9.2	11.3	10.0
Australia	2.6	-0.8	3.3	-0.8	3.3	-0.7
New Zealand	0.1	0.0	0.3	0.0	0.3	0.1
Centrally Planned Countries	147.5	-0.2	196.3	-0.7	204.2	0.3
Developing Countries	97.6	-3.4	136.3	0.3	150.3	-8.6
Asia and Far East	31.9	-0.4	42.8	2.4	46.5	-2.1
India	23.7	0.0	32.3	3.1	33.2	0.2
Pakistan	1.3	0.0	1.8	0.3	1.9	0.0
Thailand	0.7	-0.7	2.4	-2.3	2.4	-2.3
Indonesia	2.7	0.0	3.8	-0.4	4.1	-0.6
Philippines	1.3	0.0	2.0	0.0	2.0	0.0
World Total	471.7	1.3	644.9	4.4	668.1	3.8

Appendix Table 3. Rice; Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Million tons, milled equivalent)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	15.0	-0.7	16.8	-0.7	16.1	0.1
E.E.C.	0.6	0.1	0.7	0.2	0.7	0.2
U.S.A.	2.0	-1.2	3.0	-2.0	2.2	-1.2
Canada	0.0	0.0	0.0	0.0	0.0	0.0
Japan	12.1	0.2	13.1	0.4	13.1	0.6
Australia	0.1	-0.1	0.1	-0.1	0.1	-0.1
New Zealand	0.0	0.0	0.0	0.0	0.0	0.0
Centrally Planned Countries	58.2	-0.1	78.7	-0.6	80.9	-1.1
Developing Countries	89.3	-- 1)	127.8	2.4	137.5	-4.9
Asia and Far East	79.1	-0.7	111.9	1.5	120.6	-4.6
India	35.0	0.5	51.0	0.0	53.7	-0.8
Pakistan	10.9	0.0	16.1	-0.4	17.4	-1.3
Indonesia	8.9	1.0	12.0	2.2	12.6	1.3
Burma	5.0	-1.6	6.2	-1.7	6.8	-2.2
Thailand	6.1	-1.5	8.2	-2.1	8.6	-2.4
World Total	162.5	-0.8	222.0	1.1	234.4	-5.9

L 1) Export, less than 1000 tons.

Appendix Table 4. Milk and Milk Products; Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Million tons, milk equivalent)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	194.9	-3.0	230.4	-8.1	230.4	-4.0
E.E.C.	65.3	-1.6	81.9	-8.8	81.9	-7.7
U.S.A.	57.0	-0.2	57.5	0.5	57.0	-0.6
Canada	8.3	-0.2	9.8	0.0	9.8	-0.1
Japan	2.5	0.0	9.2	1.8	10.3	2.9
Australia	6.6	-2.0	8.4	-2.8	8.4	-2.8
New Zealand	5.4	-3.8	8.4	-6.2	8.4	-6.2
Centrally Planned Countries	91.3	-0.5	122.6	-3.2	123.8	1.2
Developing Countries	71.2	2.2	113.3	22.7	127.6	28.8
Asia and Far East	31.0	1.4	51.1	11.7	60.0	16.9
South Asia	28.1	0.1	46.3	9.0	54.0	13.4
East and South Asia	2.8	1.3	4.9	2.6	5.8	3.5
World Total	355.2	-1.3	455.1	7.4	477.8	30.1

Appendix Table 5. Fats and Oils (including butter); Production (or Consumption) and Balances; 1961-63 Average and Projections for 1975 (Million tons of fat content)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	16.7	2.5	20.6	-0.9	21.0	1.2
E.E.C.	4.9	2.4	5.7	2.4	5.8	2.4
U.S.A. Canada	) 8.5	) - 2.0	*) 11.9	) -4 0	) 12.0	) - 4.1
Japan	0.9	0.6	1.5	1.2	1.7	1.3
Australia New Zealand	) 0.6	) - 0.3	) 0.8	) -0.5	) 0.8	) - 0.5
Centrally Planned Countries	8.3	0.3	12.9	1.3	14.3	1.6
Developing Countries	10.3	-2.4	14.5	-2.3	16.5	-2.8
Asia and Far East	4.9	-1.0	6.4	-0.2	7.4	-0.2
India	2.5	0.0	4.0	0.7	4.5	0.8
Indonesia	0.5	-0.3	0.5	-0.1	0.6	-0.1
Philippines	0.9	-0.7	1.2	-0.9	1.4	-1.1
Pakistan	0.6	0.3	0.9	0.5	1.1	0.7
Malaysia	0.2	-0.1	0.4	-0.2	0.6	-0.4
World Total	32.9	0.3	45.7	0.0	49.0	0.0

Appendix Table 6. Centrifugal Sugar (Raw basis); Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Million tons)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	24.5	8.2	30.6	8.4	31.5	7.7
E.E.C.	5.7	-0.3	7.2	-0.4	7.5	-0.4
U.S.A.	8.8	4.9	10.6	5.0	10.6	4.5
Canada	0.8	0.7	1.0	0.9	1.0	0.9
Japan	1.6	1.3	2.6	1.9	2.9	2.2
Australia	1.5	-1.0	2.4	-1.7	2.4	-1.7
New Zealand	0.2	-0.2	0.4	-0.2	0.5	-0.3
Centrally Planned Countries	13.1	1.1	20.0	-0.7	20.6	0.0
Developing Countries	24.9	-9.9	37.3	-11.6	46.2	-17.9
Asia and Far East	6.2	-1.5	10.7	-1.7	11.9	-1.3
India	2.9	-0.4	5.5	-0.3	6.3	-0.3
Taiwan	0.8	-0.7	1.0	-0.7	1.0	-0.7
Indonesia	0.6	-0.1	0.9	-0.1	1.0	-0.1
Philippines	1.4	-1.2	2.3	-1.6	2.4	-1.6
Pakistan	(0.5)	(0.3)	(0.8)	(0.4)	(1.1)	(0.5)
World Total	52.8	-0.6	79.5	-3.9	90.6	-10.2

Appendix Table 7. Tea; Production (or Consumption) and Balances, 1961-63 Average and Projections for 1975 (Thousand tons)

Regions and Countries	1961-63 Average		1975 Low G.D.P. Assumption		1975 High G.D.P. Assumption	
	Production	Trade	Production	Balance	Production	Balance
Developed Countries	481	402	566	443	582	459
E.E.C.	20	20	25	25	27	27
U.S.A.	55	55	66	66	66	66
Canada	20	20	25	25	25	25
Japan	76	-5	99	-6	101	2
Australia	28	28	37	37	38	38
New Zealand	8	8	11	11	11	11
Centrally Planned Countries	202	-15	306	-3	321	3
Developing Countries	765	-391	1162	-587	1162	-537
Asia and Far East	688	-455	956	-594	956	-560
Ceylon	213	-201	327	-307	327	-305
India	349	-215	475(503)	-262(-290)	475(503)	-243(-271)
Pakistan	25	-2	38	-2	41	3
Taiwan	20	-14	27	-18	27	-17
Indonesia	74	-31	80	-20	80	-17
World Total	1055	-4	1591	-147	1603	-75

Appendix Table 8. Cotton; Production and Consumption, and Balances
1961-63 Average and Projections for 1975 (Million tons)

Regions and Countries	1961–63 Average					1975 Low G.D.P. Assumption				1975 High G.D.P. Assumption			
	Pro-duction	Mill consump-tion	Domestic consump-tion	Net trade in raw cotton	Net trade in manu-facture	Pro-duction	Domestic demand	Net trade in raw cotton	Net trade in manu-facture	Pro-duction	Domestic demand	Net trade in raw cotton	Net trade in manu-facture
Developed Countries	3.7	4.4	4.1	1.1	-0.1	4.0	4.6	0.5	0.1	4.4	5.1	0.6	0.2
U.S.A.	3.2	1.9	1.8	-1.1	0.0	3.3	2.0	-1.4	0.1	3.5	2.2	-1.4	0.1
Japan	--	0.7	0.4	0.7	-0.2	--	0.6	0.7	-0.2	--	0.6	0.8	-0.2
Western Europe	0.5	1.8	1.7	1.3	-0.1	0.7	1.8	1.1	0.1	0.9	2.0	1.1	0.1
Others	0.0	0.1	0.2	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.3	0.1	0.1
Centrally Planned Countries	2.6	3.0	2.9	0.4	-0.1	3.9	3.8	0.0	-0.1	4.2	4.2	0.1	-0.1
Developing Countries	4.1	2.5	2.7	-1.5	0.3	5.5	3.7	-1.7	-0.2	6.6	4.4	-2.0	-0.2
Exporting Manufactures 1)	1.8	1.6	1.4	-0.1	-0.2	2.4	2.0	0.1	-0.4	2.9	2.5	0.1	-0.5
Importing Manufactures 2)	2.3	0.8	1.3	-1.4	0.5	3.2	1.7	-1.8	0.3	3.7	2.0	-2.1	0.3
World Total	10.4	9.9	9.7	-0.0	-0.0	13.5	12.1	-1.2	-0.1	15.2	13.7	-1.3	-0.2

Notes 1) India, Pakistan, Hong Kong, Taiwan, Republic of Korea and United Arab Republic.

2) All other developing countries.

SESSION IV

Comment on H.G. Johnson's Paper by Bruce W. Wilkinson

Prof. Johnson has provided us with a succinct commentary on the current issues and alternatives for international commercial policy. Coming as it does in the middle of this conference, his statement provides a very useful frame of refenrece of the assessment and integration of the previous papers with those still to come.

My remarks will be brief because many of the issues that he has raised have also been examined in other papers. But a few comments on his assessment of the four alternative strategies for future trade liberalization are in order.

Few would disagree that it would be a retrograde step to return to using a conditional most-favoured-nation approach to trade negotiation, at least in its historical form. The sectoral approach, however, must be given a further hearing. Professor Johnson might have considered another variant of this idea--a limited participation sectoral approach, which, like a free trade area, may be open-ended to permit other nations to join subsequently. It could also be open-ended in a second sense: more sectors could be added.

Conceived of in this form, with only a few interested countries participating initially, the sectoral reduction of trade restrictions need not be blocked by the willingness of some major industrial country to participate. Nor is there any reason why the member countries could not make suitable provisions for assisting the developing countries, just as they could do in a free trade area. These matters could be entirely within the power of the member countries to determine.

A problem that might have been mentioned, however, is where to draw the line in attempting to establish free trade in a sector. Trade liberalization in component parts, capital equipment, construction materials, and repairs and maintenance supplies may also be necessary if the basic sector involved is not to suffer competitive disadvantages with foreign firms enjoying lower costs of production for these items. Such problems already have arisen with respect to the Canada-United States automobile agreement. But even this difficulty should not cause us to dismiss entirely the possibility that as a <u>practical</u> first step towards gaining public acceptance of a broader approach to trade liberalization, negotiations on a sectoral basis may prove useful.

As for more multilateral negotiations of the Kennedy Round variety, I would agree with Professor Johnson that a mere continuation of the same approach is likely to lead to less satisfactory results a second time around. But perhaps if the removal of agricultural protection and all the non-tariff barriers associated there with were made the major goal of new multilateral trade negotiations, significant result might be achieved. Surely at some point the strength of the agricultural interests in the industrialized, agricultural-importing nations must be overcome. A multilateral, non-discriminatory approach may be the answer.

Turning to the fourth alternative, free trade areas, I believe one additional advantage deserves emphasis. It offers a useful framework not only for the consideration of all sectors at once, including agriculture, but also for the consideration of all non-tariff hindrances to trade such as buy domestic policies and subsidies.

Comment on K. Hemmi's Paper by Sir John Crawford

The text of my comment[1] is to be found in two statements by Prof. Hemmi. The first on page 253 states: "However, lessons from the Kennedy Round discussions show that any further significant lowering of levels of agricultural protection in either the United States or Japan is not foreseeable." Again on page 263 we are told "Any significant tariff cut or any significant reduction of the level of agricultural protection is not practical."

If these statements are to be accepted without qualification they represent the bluntest warning that Australia can forget any worth-while negotiations on agricultural markets with either the United States or Japan. Prof. Hemmi offers the cold comfort of E.E.C.-type approaches to fixing levels of protection, ratios of self-sufficiency, and all the other devices for attempting to contain the excesses of the Common Agricultural Policy without impairing its highly protectionist character. There is no basis in this approach for any serious discussion of a Free Trade Area embracing Australia and New Zealand.

Prof. Hemmi and I agree in our judgment that a free trade association is not an early prospect if it calls for dismantling the apparatus of agricultural protectionism in Japan. The same comment applies to any expectation that industrial tariff protection in Australia will be quickly dismantled. However, I do not believe this disposes of the subject since moves towards, but short of complete free trade do offer a significant basis for further expansion in trade between Japan and Australia. I may be wrong, but, fortunately for my optimistic nature, I also believe that Prof. Hemmi has underestimated the powerful force within Japan working to moderate agricultural protectionism. For example, although it seemed intractable during Australian-Japan negotiations in 1963, the barriers to trade in meat have been usefully reduced. This is merely a pointer to the future.

[1]I have decided not to comment on the general review of commodities offered by Prof. Hemmi. He used F.A.O. data in the main. Much of these are open to question and lead, too, to some inaccuracies about the position of Australian agriculture. These, however, are minor matters.

As in Europe, Britain, and the United States, Japanese agricultural protectionism reflects the strong political weight of rural interests. Nevertheless, in Japan, the objective of policies for economic growth include raising the standards of the urban masses. Japanese consumers are pressing for the welfare benefits of economic growth and these include more varied and better quality foodstuffs. It is beyond the capacity of Japan's limited physical resources, even granted potential for increasing farm efficiency, to keep pace from its own farms with demands for meat and dairy produce not to mention dried and canned fruits.

Nor is my view based solely on this observation of Japan's limited capacity for agricultural and pastoral production. Japan's leaders know that growth policies call for rapidly expanding world markets and that not all the expansion can be provided by horizontal trade with advanced industrial countries. It must have entry to the industrial markets of Australia, among others, who will require access not only for industrial products, such as automobiles, but also for agricultural, pastoral, and mineral products. As Dr. Okita has shown Japanese dependence on Australia and other suppliers for minerals is already considerable. I believe that dependence on external suppliers for foodstuffs and feed-grains will also become highly significant, within the space of a relatively short time.

All this adds up, in policy terms, to two points:

(a) Talk of complete free-trade between Australia and Japan is quite premature, but

(b) It is not premature to expect continuous bilateral or multilateral negotiation which will call for both Japan and Australia to lessen their existing barriers to mutual trade. Both have much to gain from this course.

Since Australia undertakes even its bilateral negotiations within a GATT framework it is important to stress that Australia claims with at least legal validity that the original GATT rules did not differentiate between trade in agricultural products and trade in manufactured goods. It makes no apology, therefore, for contending, under the general "eye-for-eye" system of negotiation encouraged by GATT, that tariff concessions by it call for recognition of Australia's comparative advantage in the export of primary products.

As a technical footnote to the general discussion as well as to these comments on Prof. Hemmi's paper, I think it right to mention another difficulty in the free trade area concept. Australia's own experience with the E.E.C. suggests that a Pacific Free Trade Area would be wise to take considerable notice of the interests of other countries--the developing countries especially. Argentina might well take a jaundiced view of discrimination against its meat exports even though I doubt it will ever prove a serious supplier to the Pacific. Nor could Japan ignore potential suppliers of feed-grains and sugar from outside the free-trade area. And yet is an open-ended free trade area to be only open in respect of agricultural trade?

Discussion on Johnson's and Hemmi's Papers

Prof. Johnson explained, in response to the discussant's comments, that he had not gone into the sectoral approach for freer trade among a few countries because it was difficult to encompass within the GATT framework; but if such an approach were possible, he would grant Prof. Wilkinson's points. As regards non-tariff barriers to trade, Prof. Johnson pointed out that the record of the Kennedy Round suggested that non-tariff barriers to trade in industrial products are neither universal nor significant. A study by Gerard Curzon, now in proof, also suggests that non-tariff barriers to trade, whilst numerous, are insignificant. However, the emphasis in discussion at this conference has suggested otherwise. This difference in emphasis may be explained by two observations. First, non-tariff barriers are of special importance to trade in agricultural commodities. Second, non-tariff barriers may be more important in the trade of smaller, less fully-industrialized nations, than they are in trade among the world's larger industrial producers. In other words, the problem of non-tariff barriers may be more serious in such cases than one judges from the Kennedy-Round experience and Curzon's study.

Prof. Hemmi in turn responded to Sir John Crawford's comments by observing that there was actually little disagreement between them concerning the future prospect of trade liberalization in Japanese agriculture; Prof. Hemmi too, believed that there was a long-run tendency towards freer trade. He was also concerned to ensure that there should be orderly access to Japanese markets for agricultural commodities, and that dumping by E.E.C. countries should not be allowed to disturb the interests of Japan's major potential suppliers, Australia and New Zealand.

A remark from the floor suggested that Prof. Hemmi had been too optimistic about the future prospect of the world food supplies and that there still was a long way for the pendulum to swing towards excessive agricultural production.

The discussion then centered on the choice between the global and regional approaches to free-trade. The role of the U.S. policy was felt to be crucial. It was pointed out that a move toward a free trade area approach might lead to a division of the world into three or four trading blocks, because it would be intolerable, from the U.S. viewpoint, to leave any of her allies outside a regional trading area. The formation of such blocs could entail high political costs for the United States - such as the alienation of the E.E.C., as well as some economic damage. Furthermore, the United States currently has heavy commitments to less developed countries. In short, there appears little incentive for the United States to pursue the free trade area approach, unless, say, some catastrophe took place in Europe, or the U.S. balance of payments situation continued to deteriorate.

On the other hand, it was also observed that neither NAFTA nor PAFTA was to be regarded as an exclusivist device, but could be considered as a step towards world-wide free-trade. The current issue is how far the United States can carry her present responsibilities under the mounting balance-of-payments pressure. In fact, there are indications that she might adopt a highly protectionist path. In that eventuality, the question is what should the rest of the world, including Asian-Pacific countries, do?

Judgment about relative merits of the alternatives was seen importantly to depend upon assessment of the feasibility of further multilateral moves towards freer trade in the near future. Some grounds for optimism were enumerated. For one thing, the Kennedy Round took place under most unfavourable circumstances in so far as the E.E.C. had very little operational experience before bargaining began. For another, a great deal was learned during Kennedy-Round negotiations, and this should facilitate future multilateral negotiations. Moreover, there may have been a tendency to exaggerate the general significance of non-tariff barriers. All in all, the difficulties of a global approach may not necessarily be formidable.

Finally, several participants urged the reorientation of the U.S. policy away from the traditional, European-centered to a more Asian-directed approach. It was stated more than once that the Pacific nations were looking toward the United States for major leadership in this respect. Needless to say, the question is how to strike a balance between the two directions. Some stressed the importance of providing motivation for United States efforts in the region and of counter-acting excessively Atlantic-centered or inward-looking policies. In contrast, others saw the PAFTA proposals as a vast overcorrection of U.S. policy orientation in present circumstances. Others were of the opinion that Australia, Japan, and New Zealand could not afford to wait for United States initiatives in Asian-Pacific economic cooperation but should be prepared to take independent steps in that direction at the earliest possible opportunity.

Chapter 9 FINANCIAL ASPECTS OF ECONOMIC COOPERATION AROUND THE PACIFIC

by Richard N. Cooper
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I Introduction

This paper discusses some of the financial aspects of economic cooperation among the industrial countries bordering the Pacific Ocean. It is not confined to a free trade area, although that is perhaps the most discussed form of cooperation.

I would like to begin by identifying three quite different reasons, apart from strictly political ones, for economic cooperation based on regional groupings of countries. The first concerns allocative efficiency of national resources in a trading world in which total free trade or unilateral free trade cannot be achieved. Under these circumstances, several countries may find it mutually advantageous to eliminate barriers to trade among themselves, and this union will improve the world's allocation of resources if, in the technical jargon, trade creation exceeds trade diversion (using these terms to include consumption as well as production effects).

A variant of this rationale arises when free trade would damage unacceptably national objectives with respect to the composition of output, for example a desire to "industrialize," but where a go-it-alone policy would be very costly because of the limited size of the national market. Several countries with similar objectives therefore might find it advantageous to pursue their industrialization jointly, provided that the resulting distribution of manufacturing output within the free trade area were satisfactory to all members. Again the world allocation of resources would be improved, not with respect to free trade, but with respect to the leading alternative set of arrangements, i.e. countries industrializing individually and separately.[1]

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[1]This rationale for customs unions has been emphasized by B. F. Massell and C. A. Cooper in their "Toward a General Theory of Customs Unions for Developing Countries," Journal of Political Economy, 73 (October 1965), 461-476.

Similarly, several countries may improve the allocation of their resources by permitting free movement of factors of production--labor and capital--within the area; arguments similar to those for a trade area hold. The case of foreign investment will be discussed at some length below.

A second rationale for regional economic cooperation arises from the prevailing time pattern of international payments. Under certain circumstances, discussed more fully below, several countries may gain by pooling their reserves and investing the reserves thereby conserved in higher yielding assets. Reserve pooling can take place quite independently of trading arrangements, and may be attractive to a group of countries even if they have no interest in forming a free trade area. Also, unlike a free trade or investment area, reserve pooling does not involve discrimination against non-members.

A third rationale for regional economic cooperation arises when the members of the region all have over-valued currencies, relative to the rest of the world, and are unable or unwilling to devalue their currencies. Actions taken in lieu of devaluation, if non-discriminatory, may do unnecessary harm to other countries also with over-valued currencies. The countries may gain (with a resulting gain for the world) by retaining full freedom of international trasactions within the region but restricting payments to non-members, i.e. by forming a discriminatory bloc.

It should be noted at the outset that the first and third reasons for regional trading groups advanced here are strictly second-best solutions to the problems at hand in the sense that some other solution is superior on economic grounds. Thus to be justifiable it must also be argued that superior solutions to the problems posed are not available. The second rationale for regional groupings, reserve pooling, is also second-best in a slightly different sense. It accepts as given any existing imperfections in private capital markets, where (it is assumed) borrowing costs are substantially higher than deposit yields and the ability to borrow in times of need is uncertain. It may also be justified if a government-sponsored clearing mechanism is more efficient than using the deposit and check-writing system of commercial banks.

With this prelude, three questions must be asked about a regional grouping of the industrial countries around the Pacific Ocean: Australia, Canada, Japan, New Zealand, and the United States. First, do any of the above conditions obtain, i.e., is there any economic basis for a regional arrangement? Second, if so, do the five advanced countries bordering on the Pacific make up the best group to take advantage of the conditions for gain? Third, would all prospective participants find it in their long-run political interests to join such a grouping, even in the presence of affirmative answers to the first two questions? This last question is important because, to cast the point in economic terms, "recontracting" is even more difficult among countries than it is among business firms, and the inducement to rival reaction to a Pacific economic bloc may be high. A *ceteris paribus* assumption is not appropriate when considering arrangements of these kinds; it is necessary to ask how other countries will react. The last question applies to all the prospective members, but it applies with particular force to the United States.

Analytically, the second of these questions is perhaps the most difficult: it gets into the relatively unexplored domain of "optimum areas." Fortunately, the conference title implies a list of prospective participants in a Pacific economic area, so that question need not be answered here. I will, however, say something about the first question --the degree to which one or another of the various economic grounds for regionalism obtain in the Pacific Area -- and I will conclude with some brief and largely speculative remarks on the third question -- the political wisdom of such an area.

II Free Trade

The gains from free trade among the industrial countries bordering the Pacific arise, statically, from the reallocation of resources within the region to lower cost sources of supply and, dynamically, from the stimulus to cost-reducing investment and innovation that would result from exposing existing producers to greater competition. Against the static gains must be set the losses that would arise from diverting purchases from low cost sources of supply outside the region to higher cost but duty-free sources of supply within the region. Broad criteria for determining whether the trade-creating effects of a free trade area are likely to outweigh the trade-diverting effects have been laid down by James Maede and subsequently refined by others; basically they come down to how much the prospective members of the area have been protecting their domestic suppliers from competing producers within the prospective region, as opposed to those in the rest of the world.

An assessment of trade relations in the Pacific area has been made in the other papers, and it would be redundant to review that ground here. Suffice it to say that on superficial inspection a Pacific Free Trade Area would seem to score very high in trade creation, since Australia, Canada, and Japan all tend to protect industries in which the United States seems to have important cost or quality advantages, while the United States, Australia, and Canada all protect their industries from imports of goods that Japan produces competitively.[1] But the locus of production of labor-intensive manufactures seems to be shifting rapidly away from Japan to many less developed countries, so the very forces which would make a free trade area involving the United States and Japan more tolerable politically in both countries will also reduce the economic gains from such an arrangement.

Moreover, as noted earlier a free trade area is strictly second best, in terms of the gains from trade, to non-discriminatory free trade.[2] The countries in question are all extensively engaged in world trade, although the trade of both

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[1] This assessment leaves agriculture out of account; apart from a few commodities such as wool and dairy products, the gains in rationalization of agricultural production within the Pacific Area would not seem to be nearly so high, relative to manufactures, than would be true of some other country groups. In any case agriculture is not likely to be opened to free competition without a far greater degree of integration of economic policy than has been contemplated so far for the countries in question.

[2] A technical qualification is necessary here to allow for the possibility of a terms of trade effect, potentially resulting in a gain from systematic discrimination against the rest of the world. In my view this possibility has received far more attention from trade theorists than it warrants in practice.

Canada and New Zealand is heavily concentrated with a single trading partner, Canada with the United States and New Zealand with Britain. All would benefit from continued MFN tariff reductions, and a regional free trade area has no obvious advantage over MFN tariff reduction. Because of the structure of protection conjectured earlier, roughly the same kinds of reallocation would be required in either case.[1] However, the possibility must be allowed that MFN tariff reductions would actually take place more rapidly if a rival grouping to the European Economic Community were formed first, essentially for bargaining purposes.

III Free Capital Movements

A "free investment area" could be established in conjunction with a free trade area, or even in the absence of the latter. The practical importance of this notion arises from the strong interest of a number of American businesses, supported by the United States government, in investment abroad. Would mutual benefit proceed from a complete liberalization of capital movements within the Pacific area? And would the results be acceptable to all parties?

Creation of a free investment area would have effects on investment flows analogous to those of a free trade area on trade. There would be "investment creation" as a result of removing existing barriers to investment; and "investment diversion" as a result of removing those barriers in a discriminatory way, so that investment flows--both inflows and outflows--within the area might substitute for those that would have taken place with respect to the rest of the world. These effects should be distinguished from the effects on investment flows arising from the reduction or removal of tariffs within the area.

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[1] Again the changing structure of Japan's exports should be noted. Conceivably a free trade area among the five countries could protect all against large incursions of goods from less developed countries. The extension of generalized tariff preferences to less developed countries moves in the opposite direction, and would weaken the protective effect of a Pacific Free Trade Area.

Investment here must be thought of not only or even primarily in terms of pure capital flows, i.e., a shift of real resources (saving) from one country to another, but also in terms of transfers of management skill and technical know-how. Direct investment flows are analogous to trade flows insofar as the advantages of inflows from alternative sources can be ranked, ceteris paribus (especially with respect to the exchange rate), along some scale of benefits. Of course, the traditional supply price of "capital" is also relevant, but it becomes only one element among many. The standard assumption in trade th ory that "factors" of production do not move at all across national boundaries but that "knowledge" with respect to organization and production technique moves instantaneously is artificial, to say the least. This is particularly so when much technical knowledge is appropriable through patent rights and the like. International investment should also be thought of in terms of financial intermediation leading to an improvement in the allocation of capital.

With some important exceptions, the restrictions on foreign investment have probably been less severe than restrictions on trade. By "restrictions" I mean here deliberate policy aimed at foreign investment rather than the numerous other impediments to investment abroad which often arise from ignorance and from uncertainties with respect to other policies, for example the exchange rate or degree of exchange control. These are not designed deliberately to restrict investment, and such impediments are in any case small for the countries under consideration.

In many respects the industrial countries of the Pacific already enjoy the benefits of a free investment area, which in practice means largely the flow of the American capital to the other four countries (Table 1), although recently there has been growing Canadian interest in Japan, Japanese interest in both Australia and Canada, and Australian interest in New Zealand. Since 1963, however, portfolio capital movements have been restrained by the U.S. balance of payments program, about which more will be said below. Direct investment outflows have been, until January 1968, under less severe restraint.

Most countries do limit inward flows of direct investment capital in certain respects. Canada, for instance, strongly discourages foreign investment in Canadian banking and insurance; several European countries limit foreign investment in real estate or in natural resources. Of all industrial countries, however, Japan undoubtedly has the most severe restrictions on foreign direct investment.[1] Although Japan is relatively short of capital and has imported capital very heavily in the past decade, only a small fraction of this has been in the form of direct investment.

National positions on foreign direct investment are somewhat baffling. While no other industrial country restricts inflows so severely as Japan, many Western European countries would like to restrict capital inflows and the Common Market countries would probably do so if they could agree among themselves on a common policy. Canada complains about the American investment there and occasionally takes moves which suggest an attempt to discourage it. The United States, on the other hand, has for many years officially supported the outflow of capital, particularly direct investment, and still does so in principle, although that support is now tempered by concern with the balance of payments. Moreover, Britain too has encouraged direct investment abroad except when such investment was strongly inconsistent with current balance of payments requirements.

In many respects these positions are just the reverse of what one might expect them to be. On national economic grounds, the United States should be very skeptical of direct investment overseas, especially in other industrial countries. Capital importing countries, on the other hand, should welcome it. The United States should be skeptical for three reasons. First, direct investment overseas entails a substantial loss in taxes as compared either with investment or dividend distribution at home. U.S. corporations in 1963 received credits against their U. S. tax liabilities for foreign taxes paid amounting to $1.6 billion.[2] Corporations continue

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[1]A lucid account of the impediments to foreign direct investment in Japan, despite official commitments to liberalize such investment, is given in Leon Hollerman, Japan's Dependence on the World Economy, Princeton University Press, 1967, chapter 15.

[2]This understates the tax loss to the United States because foreign income generally becomes taxable only when it is remitted to the United States.

TABLE 1

U.S. Financial Assets in Pacific Area Countries, 1966
($ million, year-end)

	Australia	Canada	Japan	New Zealand
Direct Investment	1,918	16,840	756	146[a]
In Manufacturing	999	7,674	333	61[a]
Long-term Claims	522[b]	9,554	841[b]	n.a.
Bonds	200[b]	6,251	340[b]	n.a.
Stocks	10[b]	2,474	80[b]	n.a.
Other	312	829	421	n.a.
Short-term Claims	110	1,125	2,736	c.

a Includes "other Oceania"

b Estimated from data on transactions

c Less than $18 million

Source: U.S. Department of Commerce, Survey of Current Business; Treasury Bulletin.

to invest abroad because they do not bear this tax loss; they are interested in rates of return after all taxes, foreign and domestic, whereas the capital-exporting country as a whole should be concerned with rates of return after foreign but before domestic taxes. This ia a grant from The U.S. Treasury to other governments comparative in size to The U.S. economic assistance program. Second, there is growing evidence that direct investment in other developed countries displace exports. Business firms support foreign investment on the grounds that such investment stimulates American exports; and it is true that American-owned firms abroad import heavily from their parent firms. But these transactions must be compared with what U.S. exports would have been in the absence of overseas investment, a notoriously difficult comparison to make. A large sample of British firms, however, noted that their exports to other developed countries would generally have been larger in the absence of their direct investments there, even on the pessimistic assumption that without British investment someone else would have made the investment.[1] And those who have studied American investment abroad have found if any difference is to be noted between the behavior of American-owned firms and locally-owned firms with respect to foreign trade, it is that the American-owned firms export more with no tendency to import more, suggesting that export sales from U.S. subsidiaries displace exports from the United States. In addition, American firms introduce technology and production skills which might otherwise have to be imported in the form of goods from the United States.[2] It is, moreover, interesting to note that during the period 1957-1965 U.S. exports of manufactures increased by $3.8 billion, U.S. direct investment in manufacturing abroad (including reinvested earnings) increased by $11.3 billion, and production of manufactures by foreign subsidiaries of American firms increased by $24.0 billion, over six times the increase in exports.

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[1] W.B. Reddaway, Effects of U.K. Direct Investment Overseas, An Interim Report, Cambridge University Press, 1967, Chapter 12 and Appendix E, esp. p. 108.

[2] See A.E. Safarian, Foreign Ownership of Canadian Industry, Toronto: McGraw-Hill, 1967, chapters 4-6; and John H. Dunning, American Investment in British Manufacturing Industry, London: George Allen and Unwin, 1958.

Export displacement is more likely in a world with declining tariffs, since firms already established overseas may be reluctant to jeopardize their overseas investments by exporting from the parent, even when the parent has enough control over the technology to export competitively.

Third, direct investment abroad involves the capital-exporting country in some loss of control over its firms with respect to such matters as anti-trust policy, trade with certain countries that is proscribed for foreign policy reasons, and the like. Some of this loss of control arises simply from the greater difficulty of policing firms outside the home country, while some arises because of the jurisdictional conflicts that foreign investment produces. For example, the United States proscribes trade with China and Cuba, but Canada encourages it. American firms in Canada are caught between conflicting jurisdictions. To the extent Canadian policy dominates (as it formally has in this case), a "leakage" in U.S. control is created.

Capital-importing countries might be expected to welcome direct investment inflows, on the other hand, because they capture the tax gains on the investment inflow (in effect, there is a transfer from the U.S. Treasury to the capital-importing country), because direct investment brings with it new technology and management skills as well as capital, and because as a result of both of the foregoing effects national income in the capital-importing country is increased even if its resources were already fully employed. Direct investment inflows may admittedly create some friction between the capital-importing country and the United States, however, over American attempts to recapture some of its lost control by extending its jurisdiction to U.S.-owned firms abroad.

The actual positions taken by countries seem to reflect a misunderstanding of the issues involved, or else they reflect or narrower conception of the national interest than the foregoing arguments would suggest. Some Americans argue that a redistribution of the world's savings from the rich to poorer countries would be desirable for the world, and hence in the long run for the United States; and while redistribution from the United States to Brazil or India might be better still, redistribution to Canada or Europe or Japan is at least a movement in the right direction. But the national positions more likely reflect a desire to favor certain groups within each country. American business obviously benefits from having its options for investment enlarged and, on occasion, from being able to escape U.S. regulation or taxation. At the same time, increasing competition from foreign (e.g. American) firms will generally be detrimental to particular business interests in the capital-importing countries. They in turn can play on vague but potent nationalistic feelings in carrying their case for restrictions on capital inflow to the country at large.[1]

To return to the main point: a free investment area among the Pacific industrial nations is likely to have little effect on investment flows except for direct investment into Japan; and in that case the effect is likely to be "investment-creating" rather than investment-diverting, although there might be a few instances in which American or Canadian firms displaced European firms that would have been permitted to invest in Japan under non-discriminatory arrangements. Balance sheet figures for overseas direct investment are not available for all these countries but Table 2 shows the flow of direct investment earnings to and from the five industrial countries of the Pacific, a rough proxy for foreign investments. It indicates that relative to its size Japan has very low foreign investments abroad. Both Canada and the United States are high investors abroad, relative to total national output, with Australia and New Zealand falling in between. This pattern can be explained partially by the degree of capital scarcity in each country; but Japan, as noted above, is also a notoriously low importer of direct investment capital. These figures refer only to direct investment; both Canada and Japan are heavy net importers of portfolio capital.

The effects of a free investment area on international capital flows must be distinguished from the effects of a free trade area on capital flows when capital is relatively free to move. Impediments to trade also influence international capital movements, and the removal of tariffs and other barriers to trade among several major countries can be expected to result in a realignment of production not only within countries but

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[1]See Harry G. Johnson, "A Theoretical Model of Economic Nationalism in New and Developing States," The Political Science Quarterly, 80 (June 1965), 169-185; also his The Canadian Quandary, Toronto: McGraw-Hill, 1963, especially Chapter 2.

also between countries. There is little doubt, for instance, that the heavy American investment in Canadian manufacturing has been induced by the tariff protection which the Canadian government has accorded to local manufacturing production; in the absence of this protection much of the Canadian market for manufactures would be served directly from the United States.

This view is supported by survey evidence on the likely impact of an "Atlantic" Free Trade Area (including Japan, but not Australia and New Zealand) on the foreign investment plans of American firms.[1] Of the 169 firms that replied, 82 indicated that an AFTA would not affect their overall foreign investment plans, 46 indicated that they would contract their overseas operations (or cut back expansion plans), relying to a greater extent on exports from the United States, and 41 indicated that they would expand their overseas operations even more, partly to export to the United States. Only one firm, however, indicated that it would expand its Canadian operations, and many of those who reported that their total overseas investment would be unchanged indicated a switch from Canadian production to Japan or Europe.[2]

This partial view of the problem does not offer a complete answer to the effect of tariff changes on capital movements. In general, there will be a movement of capital and other factors of production out of tariff-protected industries and into the export industries on the reciprocal removal of tariffs among

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[1] M. E. Kreinin, "Freedom of Trade and Capital Movement--Some Empirical Evidence," Economic Journal, 75 (December 1965), 748-758.

[2] This view of Canadian prospects under free trade with the United States is implicitly disputed by the Wonnacotts, who feel that Canada's lower labor costs would give Canada a great cost advantage in many manufacturing lines if they were given a chance to serve the entire North American market. They make the implausible assumption, however, that under free trade Canadian labor productivity would rise to the level in the United States, while Canadian wages would remain lower. See R. J. Wonnacott and Paul Wonnacott, Free Trade Between the United States and Canada: the Potential Economic Effects, Cambridge: Harvard University Press, 1967.

TABLE 2

Total Direct Investment Earnings[a] and GDP, 1965

	Receipts (US $ million)	Payments	Gross Domestic Product ($ million)
Australia	57	264	22.1
Canada	135[b]	537[b]	48.9
Japan	14	36	84.8
New Zealand	8	77	5.3
United States	5486	749	676.9

[a]Including reinvested earnings

[b]Encluding reinvested earnings; reinvested earnings of foreign enterprises in Canada were $272 million in 1961.

Note: Data on direct investment outflows and earnings are notoriously shaky and non-comparable. For instance, U.S. data show Japanese direct investment earnings in the United States alone to be $22 million in 1965, and U.S. earnings in Japan to be $91 million.

Sources: IMF, Balance of Payments Yearbook, vol. 18, 1961-65. International Financial Statistics several trading partners--or, more correctly, out of some lines and into others in each "industry," since trade in manufactures increasingly takes the form of specialization within broad industries rather than between them. The net effect on the demand for capital in any one country depends on how capital-intensive the export industries are, on average, relative to the import-competing industries; and on the increase in exports relative to the increase in imports. The initial effects of trade liberalization would probably be a sharp increase in Canada's net imports (probably true for Australia too) and a sharp increase in Japan's net exports. But these changes would create imbalances requiring monetary adjustment to reduce the disparities in effect on imports and exports. Thus the categories "export industry" and "import-competing industries" may themselves shift. For example, some manufacturing industries in Canada <u>now</u> requiring protection would become competitive at a lower exchange rate.

The only quantitative information we currently have on the factor intensity of imports and exports arises from a series of empirical studies based on input-output analysis, beginning with Leontief's celebrated study of the factor intensity of U.S. foreign trade.[1] Unfortunately the results of these studies are counter-intuitive. Leontief's study suggests that a parallel increase in U.S. exports and imports of goods in competition with domestic production would lead to a net release of capital,[2] while the studies by Wahl and by Tatemoto and Ichimura suggest

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[1] W.W. Leontief, "Factor Proportions and the Structure of American Trade: Further Theoretical and Empirical Analysis," <u>Review of Economics and Statistics</u>, 38 (November 1956), 386-407; Masahiro Tatemoto and Shinichi Ichimura, "Factor Proportions and Foreign Trade: The Case of Japan," <u>Review of Economics and Statistics</u>, 41 (November 1959), 442-446; Donald F. Wahl, "Capital and Labour Requirements for Canada's Foreign Trade," <u>Canadian Journal of Economic and Political Science</u>, 27 (August 1961), 349-358.

[2] Actually, Leontief's results on this point were quite sensitive to the definition of "import-competing" and to the particular year chosen; perhaps a more cautious conclusion to be drawn from his study is that a parallel increase in exports and imports would not much affect the net demand for capital. <u>Op</u>. <u>cit</u>., pp. 397-398.

that a parallel increase in exports and imports competing with home production in Canada and Japan would lead to a net increase in demand for capital in each of those two countries, i.e. reducing protection would raise the rate of return on capital. With international capital mobility, these changes would lead to an increase in the flow of capital from the United States to Canada and to Japan.[1]

The calculations cited above apply to total trade, not merely to trade within the Pacific area. Wahl's estimates for the capital content of Canada's trade with the United States, however, reveal for a parallel increase in trade an even larger increase in the demand for capital than would be true for total trade; some evidence offered by Tatemoto and Ichimura for Japanese trade with the United States, in contrast, suggests that a parallel increase in such trade would reduce the demand for capital in Japan and would increase the demand for labor, a result that conforms more closely with expectations based on neo-classical trade theory.

The methodology underlying these calculations has been criticized on a number of grounds that are not necessary to recount here. They do not offer a firm enough foundation for indicating clearly what the long-term effects of tariff reduction on international capital movements will be. We are therefore left with the view that in the short run elimination of tariffs among the Pacific countries would probably result in a reduction in capital movements to Australia and Canada and (if it were permitted) an increase in capital movements into Japan, but that in the long run, after monetary adjustment to correct imbalances in payments had taken place, it is less clear what the effects on capital movement would be.

IV Reserve Pooling in the Pacific

A second form of regional economic cooperation, very different from a free trade area or a free investment area, involves the pooling of foreign exchange reserves. Countries can benefit by taking advantage of misalignments in their net payments positions, whether these arise from seasonal fact-

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[1]This assumes the domestic supply of capital is unchanged by the shift in composition of output.

ors or from other relationships, to conserve on the need for international reserves. I assume that countries hold international reserves primarily to settle occasional deficits in their international payments, and that the amount of reserves that they need to meet these contingencies is directly related to the expected size of the contingencies, e.g. to the expected standard deviation of disturbances to the balance of payments. To the extent that these contingent payments deficits are less than perfectly correlated with those of other countries, some of the reserves held as a precaution against the deficits can be "saved" by pooling reserves in such a way that each of the participating countries can draw on the pool when in payments deficit.

The data in Table 3 indicate the extent to which the reserve changes of the five industrial countries around the Pacific were in fact correlated during the period 1955-1966. The standard deviation of year-to-year reserve changes (in billions of U.S. Dollars) for each country is shown on the main diagonal. The entries above the diagonal record the correlation coefficients for reserve changes[1] of the indicated pairs of countries, and the entries below the diagonal show the covariances, that is, the product of each correlation coefficient with the two relevant standard deviations.

Gains from reserve pooling arise for any degree of correlation less than unity, but the gains increase the correlation falls.[2] The highest positive correlation between reser-

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[1]A crude proxy for payments imbalances. For the United States, <u>net</u> reserve changes have been used, i.e., reserve changes less changes in liabilities to foreign monetary authorities. The year-to-year reserve changes of Canada were reduced during 1955-61 by use of flexible exchange rates and more recently by an agreement with the United States on its reserve level.

[2]Algebraically, the standard deviation (S_n) of combined reserve changes for n countries is given by the expression:

$$S_n = (\Sigma s_i^2 + 2 \sum_{j>i} \sum_{i} r_{ij} s_i s_j)^{\frac{1}{2}}$$

The expression in brackets will be smaller the smaller are the correlation coefficients r_{ij}, i,j = 1, 2,... n. S will equal the sum of the individual standard deviation s_i only if r_{ij} = 1 for all i,j,. The assumption in the text is that at least some part of desired reserves for each country i is proportional to s_i.

TABLE 3

Bilateral Relationships Between Changes in Reserves[a], 1955-1966

	Australia	Canada	Japan	New Zealand	United States
Australia	.287	.09	-.63	.05	.35
Canada	.005	.174	.06	.15	-.48
Japan	-.046	.002	.256	.42	-.74
New Zealand	.006	.001	.004	.038	-.33
United States	.131	-.107	-.246	-.016	1.297

[a]Including reserve position at the IMF. For the United States, changes in reserves less changes in liabilities to foreign monetary authorities.

Note: Entries above diagonal are correlation coefficients (r_{ij}), entries along the diagonal are standard deviations (S_i in billions of U.S. dollars), and entries below the diagonal are covariances ($r_{ij}S_i S_j$).

Source of original data: International Financial Statistics.

ve changes of these countries during the period in question (Japan and New Zealand) was .42, while there were several high negative correlations. It is clear from inspection of the covariance terms that large absolute gains from reserve pooling the period in question would have arisen by pooling reserves between the United States and Canada, between the United States and Japan, and between Japan and Australia.

For the five countries taken together, the standard deviation of year-to-year reserve changes would have been $1,145 million, compared with $1,297 million for the United States alone and a sum of standard deviations for the countries taken separately amounting to $2,052 million. Thus pooling of reserves would have reduced the need to hold reserves against contingent payments deficits by 44 percent. This could represent a substantial savings,[1] and if the experience of the past decade is any guide to the future, it suggests that reserve pooling might be mutually beneficial. While the correlation coefficients for the period 1955-1966

[1]The actual amount of the saving would depend on the relationship of precautionary reserve holdings to the expected variation (s_i) in reserves, and this in turn would depend on the degree to which payments deficits were serially correlated and on the degree of "risk aversion" the authorities of each country had to the exhaustion of precautionary reserve holdings.

undoubtedly do include some accidental elements, they also reflect the ties of trade and capital movements among these countries. The United States is the largest trading partner of both Canada and Japan, and Canada and Japan are the largest single trading partners of the United States. Portfolio capital movements are also very large between the United States and each of these countries, the two countries together taking about half of total U.S. portfolio outflows before 1965. It is surprising, therefore, that when the payments position of the United States deteriorates, that of the other two tends to improve, and vice versa. Mutually strong trading ties also exist between Australia and Japan, so the payments positions of these two countries tend to move in opposite directions for the same reason.

To say that these countries could benefit by reserve pooling assumes, however, that they have not already been doing so. Yet the Sterling Area, of which both Australia and New Zealand are members, can be viewed precisely as a reserve-pooling arrangement whereby all members agree to turn in their "reserves" (gold and dollars) to Britain, receiving in exchange claims in sterling; and the gains from this reserve pooling are distributed to members not only through interest earnings on their sterling claims, but also through access to the London capital market. In effect, some of what would otherise have to be held in the form of gold and dollar reserves has been converted into real capital by importing more from the non-Sterling Area.

Similarly, both Japan and Canada have engaged in partial reserve pooling with the United States. Both countries hold a large portion of their reserves in dollars, having partially foregone the purchase of gold for the sake of holding interest-bearing assets. The pooling of gold in the United States has permitted a larger volume of imports or larger purchases of assets in the rest of the world than might otherwise have taken place. The sale of gold by Canada to the United States in 1966 and 1967, while undoubtedly motivated by more immediate concerns, can be rationalized along the lines suggested here.

It should be recalled that gains are to be had from reserve pooling only if private capital markets are imperfect. Otherwise, private lending from surplus to deficit country could be relied on to cover reversible and mutually interacting payments deficits and surpluses. It is note worthy that both Canada and Japan hold reserves that are considerably less in relation to trade than is typically true of industrial countries (the same is not true of Australia, but New Zealand operates on a very narrow base of reserves relative to trade). This suggests that they have relied in part on the New York financial market as a source of occasional balance-of-payments support. Moreover, until the past few years both countries have had gains from further reserve pooling would probably have been small, since it would have been difficult to improve on existing arrangements through this device. More recently, however, "imperfections" in capital markets have been introduced by the U.S. balance of payments program, both the form of the interest equalization tax and through the voluntary credit restraint program. That brings us to the third possible economic rationale for regionalism.

V <u>Regionalism and Imbalances in Payments</u>

A third rationale for regional economic groups involves imbalances in international payments. The basic problem is this: when a major country, or grouping of countries, runs into balance of payments difficulty and takes palliative action to reduce its payments to foreigners, its actions may increase the deficits of other countries or create deficits for countries that were initially in surplus. Those countries too will be induced or forced to reduce their payments to foreigners. Now it could be argued that basic weakness in the payments position of those countries were concealed initially by the deficit of the large country. In a world of floating rates, the currencies of all these countries would depreciate relative to other currencies, the extent of depreciation depending not only on the degree of initial overvaluation but also upon the sensitivity of each country's external transactions to changes in relative prices.

We do not live in a world of flexible exchange rates, however, and it is well known that countries can continue for prolong periods with ex ante balance of payments deficits, partly financed by declines in reserves or by borrowing, partly suppressed through unwanted restrictions on international transactions or on domestic demand. When balance-of-payments adjustments policies are non-optimal, their non-discriminatory application may result in a larger loss of world output than would be true if they were applied in a discriminatory manner. This is especially true when the payments "feedbacks" between two or more countries are large, so that contraction of payments by one country compels the second also to reduce its payments to foreigners, and this in turn worsens the first country's payment position again. Put another way, payments restrictions or deflation under these circumstances have a very low leverage over the balance of payments, gross transactions having to be restricted by a large multiple of the final net improvement.

It is this observation that provides the basis for a regional grouping based on balance of payments considerations. Several countries reasonably satisfied with their payments positions vis-á-vis one another but running overall payments deficits with the world when pursuing desired economic objectives might find it mutually advantageous to restrict their payments to the rest of the world in concert, preserving freedom of international transactions within the region.

The Sterling Area in its early days offers an example of such a regional grouping, when restrictions on both current and capital payments to the rest of the world were very severe but transactions with other members of the Sterling Area were largely unrestricted. Over the course of time, the distinction between members and non-members has become much less marked, with restrictions on payments outside the area declining, and with some members increasingly restricting payments even within the area. But in the late forties and early fifties the Sterling Area preserved freedom of international transactions in a large area during a period in which the world was beset by acute currency difficulties and widespread restrictions on payments.

More recently, discrimination on a minor scale has been introduced into the relations between the United States, on the one hand, and Canada and Japan. For balance of payments reasons the United States has adopted a variety of techniques, ranging from a tax on U.S. purchases of foreign securities to a program of "voluntary restraint" by American businesses investing abroad, to curb the outflow of capital. It has also restricted severely government purchases abroad (particularly relevant to foreign aid expenditures and to procurement for U.S. military forces abroad), and there has been consideration of restricting capital outflows further and imposing a tax on international travel by Americans.

These restrictions have had an undesirable impact on other countries. Imposition of the Interest Equalization Tax (IET) on U.S. purchases of foreign securities induced what became known as the "Kennedy Slump" in the Japanese stock exchange; Korean manufacturing industries growing handsomely on the strength of U.S. aid purchases and military servicing were given a sharp set-back; and Canada was so concerned about the threat of the IET to the new Canadian exchange rate that it made major protest to the United States and was given a partial exemption from the tax. Since that time Japan has also been accorded a partial exemption from the IET, less generous than that given to Canada, but still recognizing the special economic linkages between the United States and Japan.[1] But total U.S. lending to Japan dropped very sharply (Table 4), and attempts by Japan to find capital in Europe have been only partially successful. Canada and Japan (along with the United Kingdom) have also been accorded special status under the "voluntary credit restraint program" applicable to foreign lending by American banks.

The situation remains uneasy. The near term outlook for the U.S. balance of payments suggests the continuation of substantial deficits for several years, and the U.S. government may feel obliged to impose further restrictions on international transactions. Non-discriminatory restrictions will hurt the payments positions of countries with close economic linkes with the United States, and in some cases will perhaps even require those countries to take counter-measures, damaging both to them and to the United States.

The control point is that under such circumstances there may be mutual gains from forming a discriminatory bloc. In most cases it would be necessary for <u>all</u> members of the bloc to discriminate against the rest of the world, to prevent "arbitrage" transactions through the members who did not dis-

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[1]Less developed countries, excluding petroleum exporters, were also exempt from the IET. This was partly a political gesture (these countries do not borrow heavily on the U.S. market in any case), partly a recognition that lending to these countries does not, after allowing for the stimulus to exports, have the same deleterious effect on the balance of payments that lending to a European country would, partly an attempt to avoid blatant contradiction between balance of payments policies and the U.S. government's effort to encourage the flow of private capital to less developed countries.

criminate, such as the notorious "Kuwait Gap" in the Sterling Area in the mid-fifties. Canada has had to police its financial community informally to discourage leakages of American funds through Canada to Europe (a special problem is the unloading of American securities in favour of higher yield issues of American subsidiaries in Euope). Japan's exemption from the IET was until 1967 confined to government or government-guaranteed bond issues, presumably to inhibit leakage. In addition, agreements have been reached with both countries regarding total reserve levels. Thus the discriminatory bloc either has to be a limited, low pressure bloc, or it requires close coordination on framing and implementing the discriminatory policies. This is especially true for capital movements.

TABLE 4

U.S. Capital Flows to Australia, Canada, and Japan, 1961-66.

	1961	1962	1963	1964	1965	1966
			($ million)			
Canada						
Direct Investment[a]	302	314	365	253	912	1087
Bank lending	131	--	98	70	-391	-81
Other	632	396	455	1226	60	484
Japan						
Direct Investment[a]	29	54	68	78	19	31
Bank lending	674	263	586	618	-44	-385
Other	125	210	185	1	12	-11
Australia						
Direct Investment[a]	82	104	96	125	136	147
Bank lending	-5	35	24	37	86	103

[a]Excluding reinvested earnings

Source: U.S. Department of Commerce, Survey of Current Business; Treasury Bulletin

Again the question can be asked whether the five industrial countries bordering the Pacific comprise the right group for a discriminatory bloc. The very heavy dependence of Canada and Japan on U.S. capital, and the rapidly growing dependence of Australia on U.S. capital, suggest that it may be. Although capital imports do not provide a large portion of domestic capital formation (never more than five percent of Japan's gross fixed capital formation in the past decade, 10-15 percent of Canada's, or 10-20 percent of Australia's), their contribution is large enough to avoid being strictly marginal, and the possibility of borrowing abroad undoubtedly lowers interest rates and improves the allocation of capital by providing external financial intermediation. As noted above, trading ties between these countries are also high. Finally, the balance of payments positions of all of them could be characterized as weak, given their various domestic and international objectives.

The difficulty with this rationale for a regional grouping is that it is very likely a transitory one; it does not provide the basis for a durable regional arrangement, since the balance of payments interests of these countries are not likely always to be inharmony. It does argue for a careful look at temporary arrangements, however, and possibly for putting discrimination on a more orderly and systematic basis than the *ad hoc* discrimination that has taken place so far.

VI The Political Element

Sections II-V above suggest that the economic case for a regional grouping of the industrial countries bordering the Pacific, while not wholly absent, is not a compelling one--partly because some of those advantages are already being enjoyed through existing arrangements. This is true especially of long-term capital movements (with the exception of direct investment into Japan) and reserve pooling. The evidence on trade has been considered by other papers. The balance-of-payment rationale for regionalism may become much stronger if the United States imposes much heavier restrictions on its international payments than it has so far, the effects of those restrictions on Canada and Japan having been mitigated in part by *ad hoc* discriminatory arrangements. But if the United States does take more severe restrictive action, there would be an equally strong case for giving special treatment to other countries, such as Mexico.

As argued above, the various economic arguments for regionalism are all second-best; advocacy of them implies that superior courses of action are closed off. It would not be so despairing. While the Kennedy Round tariff reductions fell short of initial expectations, the final result was a substantial move in the direction of freer trade. It is too early to conclude that another round of generalized tariff reductions, including also non-tariff barriers, will not be possible in the early seventies. The impediments to international capital movements remain overwhelmingly those of ignorance and uncertainty regarding general economic policies rather than artificial barriers to capital movements as such, and until the past few years the trend has been strongly toward greater liberalization. Discriminatory trading and investment arrangements are justified only if these trends towards greater freedom are decisively reversed.

If the economic arguments are not very compelling, is there a powerful political case for Pacific regionalism? From the viewpoint of the United States, the opposite is probably true, at least at the present time. For the United States to join a regional arrangement of any permanence would be likely to generate a scramble by many smaller countries to associate with the larger Pacific or European groups, and it would be difficult to resist their entry. Many Latin American countries, for instance, would doubtlessly want to associate with a trade bloc including Canada and the United States. With the principle of non-discrimination abandoned, what would be the grounds for their exclusion?

Permitting privileged access to markets would reintroduce a sharply divisive element into international politics. Adherence to MFN has served to insulate international trade at least partially from other dimensions of international politics. Further retreat from non-discriminatory trade would open up the possibility -- indeed the likelihood -- that trade favours will be exchanged for other favours. In the end economic objectives could be badly maimed.

Chapter 10 A PACIFIC BANK FOR INVESTMENT AND SETTLEMENT -- ITS CONCEPTION

by Einosuke Ashiya
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I Introduction

The conception of a Pacific Bank for Investment and Settlement (hereinafter referred to as "the Bank") is aimed at creating a regional financial institution that has investment and settlement functions in combination to serve the dual purpose of facilitating investments and expanding trade among the five countries situated on the coast of the Pacific Ocean --- the United States, Canada, Japan, Australia, and New Zealand.

If long-term investment and finance are to be facilitated, there should be a system under which the long-term capital invested or long-term loans extended could not leak out of the Pacific area through the purchase of capital goods and the like from outside the area. Such a leakage of capital would, in turn, put pressures on the balance of payments positions of the countries within the area. As the world economy is now heavily dependent on the United States dollar, any leakage of dollars to European countries would result ultimately in gold losses on the part of the United States, hindering the promotion of U.S. long-term investment and finance in consequence. This is clearly testified by the current dollar "crisis." Actually, such a development has led to a further strengthening of U.S. dollar protection by means of reducing U.S. foreign aid and restraining private capital outflows.

Next, with the expansion of trade within the Pacific area in view, there should be stable settlement system. Today, apprehensions about currencies persist in the world; the flurry of confidence in not only international currencies but other currencies impedes the expansion of world trade, as is clear from the current state of trading, which must be averted in one way or another.

Through the performance of these two functions, the Bank is expected to play the two major roles.

The first role concerns the investment function of the

Bank. The Bank will accept from recipient countries as deposits (1) the amount of capital estimated to leak out to outside the area on the basis of past records as regards governmental credits and donations, and private investments and loans abroad and (2) the amount of capital equivalent to that of investments and loans in cases where such investments and loans are made out of the Bank's owned capital.

The capital funds thus accepted by the Bank will be transferred exclusively among the five countries within the area; hence, such funds are to be utilized for the procurement of goods from the five countries.

The second role relates to the settlement function of the Bank. The Bank will institute a system under which the currencies of the five countries are used and then into a clearing system virtually with the Bank as its center. In order to make this system function smoothly the Bank will extend short-term loans to the five countries within the area.

II <u>The Investment and Loan System</u>

With the aim of facilitating long-term capital investment and finance, the Bank will have a department that functions to help circulate the capital invested or loans extended among the countries within the area without leaking out to outside the area.

This concept is based on the "Lent Currency" proposal advanced by Prof. Kojima of the Hitotsubashi University. The proposal finds solution to the international liquidity problem in increasing the volume of liquidity, maintaining confidence and improving the process of international payments adjustment, all on an international scale, with the International Monetary Fund taking the central part.

Note: For details of Prof. Kojima's "Lent Currency" proposal, refer to the following literatures:

"Japan's Foreign Trade and Tariff Cuts" by Kiyoshi Kojima, p. 192-204

"My Proposal for Increasing International Liquidity" (I), (II) by Kiyoshi Kojima, the Oriental Economist, August 1, 8, 1964.

"I Revise My Proposal for Increasing International Liquidity" by Kiyoshi Kojima, the Oriental Economist, October 3, 1964.

"A Proposal for Increasing International Liquidity" the Oriental Economist, August 1964 p. 549-551.

"How Aid Could be United" the Economist, July 25, 1964, p. 401-402.

"Letters" the Economist, August 15, 1964, p. 609.

An investment and loan system of the Bank will merely have a limited function for the time being in facilitating investments and loans on a regional basis, and pave the way for development into an international scheme as proposed by Prof. Kojima.

There are two major prerequisites to the establishment of the investment and loan system. The first prerequisite pertains to the character of long-term capital for investment and finance. Such capital funds are divided broadly into three: governmental credits and donations, private investments and loans abroad, and investments and loans by the Bank out of its owned capital. It should be noted that investments and loan grants among the five countries will have to depend almost entirely on private capital. As regards investments in and loans to developing countries, governmental capital carries much greater weight than private capital (see Table 1). Hence the need of special consideration to the formation of a mechanism that will work to facilitate private capital investments and loans. The second involves the division of areas in which such long-term capital funds are invested or accommodated. Cases of long-term capital investment and finance are divided by area into two: developed countries within the area and developing countries in Central and South America and Southeast Asia.

TABLE 1

Geographical Distribution of Financial Flows to Less Developed Countries

(in millions of U.S. dollars)

		Far East & South Asia						Latin America					
		'60	'61	'62	'63	'64	'65	'60	'61	'62	'63	'64	'65
U. S.	Private	175	147	45	212	254	702	540	653	337	479	683	689
	Official	1,547	1,329	1,585	1,890	1,895	1,914	611	184	697	569	549	413
Japan	Private	60	82	44	51	37	52	26	32	36	10	11	44
	Official	82	93	86	119	116	205	20	-5	3	-6	9	-11
Canada	Private	na	na	na	na	na	na	na	na	na	na	na	na
	Official	43	40	24	50	69	59	6	5	3	20	35	34

Source: O E C D Statistics

In consideration of these two prerequisites the Bank should adopt the investment and loan system that combines these prerequisites and meet each of them.

In the first place, capital movements in the form of governmental credits and donations are made to developing countries in Central and South America and Southeast Asia rather than to developed countries within the Pacific area.

Bilateral aid of this kind, as extended by the five countries other than the United States, is almost "tied" in character, so no particular consideration is needed. In the case of the United States, the share of "tied" aid in the total has been rising sharply in recent years, as Table 2 indicates, though the "untied" proportion still remains.

Table 2. Changes in the Proportion of "Tied" Aid from the Agency for International Development

1959	47%
1960	41%
1961	44%
1962	66%
1963	79%
1964	87%
1965	92%
1966	90%
1967	95%

Source: A.I.D. Quartery Report: "Trend of A.I.D. Commodity Expenditures of Procurement by Resources"

With an eye to preventing a decline in U.S. governmental credits and donations the following operatons need be conducted.

1. In cases where the United States has granted its governmental credits and donations to a certain country in the region of Central and South America and Southeast Asia, the country will deposit the

"untied" part of such credits and donations with the Bank in an account opened in the name of the central bank of that country.

2. The Bank is required to hold the U.S. dollars it has accepted from the country as the reserve against the deposits made in the name of the country's central bank. The Bank is not allowed to claim conversion of the dollar deposits into gold.

3. The country that has received U.S. governmental credits and donations is not permitted to convert its dollar deposits with the Bank into U.S. dollars in circulation but may add the dollars deposited with the Bank to the external reserves of the country.

4. The country is authorized to use the dollars deposited with the Bank exclusively for the payment of imports from the five countries within the Pacific area.

5. Commercial banks of the countries within the area other than the United States that have received dollars from the Bank are authorized to use the dollars for settlements within the area.

6. In cases where the United States has received dollars from the Bank, the country may claim conversion of the dollars into the dollars which the Bank has initially accepted and holds as the reserves.

The second, as noted already, involves cases in which private long-term capital is invested in, and long-term loans are extended to, the developed countries within the area and the developing countries in Central and South America and Southeast Asia. A mechanism similar to that is to be applied to governmental credits and donations will be adopted in this case. By utilizing the Bank in this way it may be made possible to mobilize private capital indefinitely.

For the most part, direct investments are usually placed in, and long-term loans extended to, the developed countries on a cash basis, so the amount of such investments and loans is to be deposited with the Bank.

Considering that private capital investments and long-term loans by the five developed countries are generally made through commercial banks and that such resources are used by the banks in the form of foreign currency holdings, the Bank will be given freedom to use the currency deposited with the Bank in the name of the commercial bank concerned for settlements among the five countries within the area.

In cases where private capital of the five countries is invested in or loaned out to the countries of Central and South America and Southeast Asia, they are required to deposit a portion of the capital prescribed as "local costs" with the Bank through the central banks. In the case of Japan, for instance, when a Japanese private enterprise advances into the underdeveloped area it offers in kind capital goods needed for the establishment of an enterprise and takes U.S. dollars into a developing country to use the funds after converting them into local currency for the payment of personnel expenses, electric power and other costs and outlays for the purchase of land, all needed for the construction of a plant. Incidentally, these expenses and costs are collectively termed "local costs." It is estimated that such local costs account for about 30 percent of the total capital needed. Be that as it may, there is a possibility that the U.S. dollars exchanged for local currency, after being added to the foreign currency holdings of the developing country, will be used for purposes not related to the venture concerned.

Such a possibility could be avoided if the five countries deposit the amount equivalent to the local costs with the Bank, thereby preventing any leakage of their external reserves to c countries outside the area.

As the U.S. dollars deposited with the Bank are used for settlements among the five countries, if Japan takes out the yen into the developing country instead of U.S. dollars, it will lead to the same result. For, the deposits with the Bank, whether they are made in U.S. dollars or Japanese yen, are treated in the same way as the Bank's currency. By so doing, the external reserves of the countries making investments or loans are saved.

The third concerns cases in which the Bank uses its owned capital. The capital will consist of not only the currencies of the five countries but funds raised in the capital markets in continental European countries. In this case, the capital will be used through transfer operations within the Bank.

As the Bank conducts the operations mentioned above, the five devèloped countries are required to open deposit accounts with the Bank in the name of commercial banks and similarly the developing countries are asked to open deposit accounts with the Bank in the name of respective central banks, and transfers are to be made among these deposit accounts.

III The Settlement Mechanism

The Bank will perform settlement and financing functions. As its financing function the Bank will grant short-term loans under the overdraft facility. Primarily, the facility provided by the International Monetary Fund is to be utilized in financing activities, but payments gaps caused by settlements among the five countries have to be filled immediately and the period in which such finance is needed covers no more than several days. Herein lies the reason for equipping the Bank with the financing function.

As a settlement mechanism three major systems may be applied for the operation of the Bank: utilization of the present key current system, creation of a common currency, and establishment of a clearing system. In this conception of the Bank, it is advisable to adopt a clearing system under which the currencies of the five countries are used.

A system that uses the U.S. dollar alone is problematical as evidently illustrated by the present chaos in the international financial community. If only the U.S. dollar is used, settlements among the five countries are made in New York, implying the virtual adoption of a clearing system. Yet, if such a system is reinforced, it will face the general problems confronted by the international financial community and the New York market will have to play the role which the London market has once done in the past. Moreover, the United States must take it for granted wholesale assistance to the four countries within the area. In the present circumstances the United States can hardly be expected to play such a role.

The creation of a common currency is ideal. But, this cannot be expected to realize for the time being in view of the fact that time is not yet ripe for the European Economic Community for such an attempt. Notably, the creation of a common currency has to presuppose adjustment in fiscal and monetary policies among the countries concerned. Considering, moreover, that the Pacific area is one that involves an international currency---the U.S. dollar---the creation of a regional common currency on top of the dollar is not advisable.

Restoration to the gold standard runs counter to progress in the international monetary system. A regional currency system, if adopted, implies strong ties among the countries within the area; here, it should be noted that the system is based on greater confidence in mutual ties and higher mutual credit compared with the gold standard.

A. A Clearing System under which the Five Currencies are Used.

Under the proposed clearing system the currencies of the five countries are used and settlements among these countries are virtually cleared to some extent. The system may be explained in more detail as follows:

1. Trade and other payments among the five countries will be settled in U.S. dollars, the Japanese yen, Canadian dollars, Australian dollars and New Zealand dollars.

2. An exchange market will be formed for these currencies other than the U.S. dollar. These currencies have so far been not used in any significant amount because they are unstable compared with the U.S. dollar and no system obtains for the avoidance of risks incurred in their use. So, the Bank will open the way for covering exchange risks by acting to buy and sell these currencies.

3. By buying and selling these currencies spot and forward the Bank will meet requirements for the purchase and sale of these currencies. This virtually implies transactions under the clearing system.

4. Credits and debts accumulated with the Bank or holdings of the five countries' currencies will be cleared for every certain specified period of time, thereby restoring the capital formation of the Bank,

as composed of the five countries' currencies, to its initial state.

As Table 3 suggests, U.S. dollars held by the Bank will decrease while other four currencies will be accumulated. As this hinders the smooth operation of the settlement mechanism, the Bank will sell the four countries' currencies it holds in excess of the initial subscription to the respective central banks in exchange for U.S. dollars for every certain specified period. This enables the Bank to restore its initial capital formation.

Table 3. Balances of Trade among Five Countries in 1966

(in millions of U.S. dollars)

	United States	Canada	Japan	Australia	New Zealand	Total
United States		745	-354	385	- 4	772
Canada	- 923		81	89	21	- 732
Japan	153	- 141		- 233	0	- 227
Australia	- 458	- 94	167		138	- 247
New Zealand	7	- 27	- 9	- 135		- 164

Source: Direction of Trade, I.M.F.

B. Formation of an Exchange Market for Four Currencies

The currencies of the four countries---Canada, Japan, Australia, and New Zealand---cannot be used because they lack in marketability. Herein lies the need for forming an exchange market for these four currencies. So, the Bank will be accorded the following functions:

1. The Bank will receive reports from the central banks of the five countries on exchange rates of their respective countries' currencies for the U.S. dollar and on the amount of U.S. dollars they can buy from

and sell to the Bank on a certain specified date on the basis of the exchange rates to help the Bank adjust its exchange positions. Each of the central banks is well aware of the supply-demand situation in the exchange market of the country to which it belongs, and intervene in the market, if need be. Hence, the Bank will act on the basis of the central banks' intention to intervene in their respective markets. When an exchange market has been formed for the four currencies in the future and transactions have expanded and become multilateral, the Bank will then be able to intervene in the exchange markets on its own judgment. At the outset, however, the Bank will have to depend on the central banks in the sense of re-insurance.

2. On the basis of the central banks' intention to intervene in their respective markets the Bank publishes buying and selling rates for the five currencies and acts to cover both spot and forward exchanges at the request of exchange banks. In this case, the Bank is required to set the spread between its buying and selling rates at minimum with the view to increasing transactions in the market.

3. The Bank will be able to seek cover, when necessity arises, to the central banks for the five currencies which the Bank has come to hold after meeting cover requirements for the five currencies at the middle rates of the exchange rates published by the Bank for the currencies concerned.

4. To make such operations possible for the Bank exchange banks are to report to the Bank about the holdings of the five currencies.

5. After the formation of the exchange market for the four currencies the Bank will discontinue such operations, and at the time of discontinuation it will have its holdings of the five currencies bought back by the respective central banks. Exchange profits or losses likely to stem from exchange purchases and sales will be dealt with when such cases arise.

IV Merits of the Clearing System

Merits likely to accrue from the according of a virtual clearing function to the Bank through the use of the five currencies may be enumerated as follows:

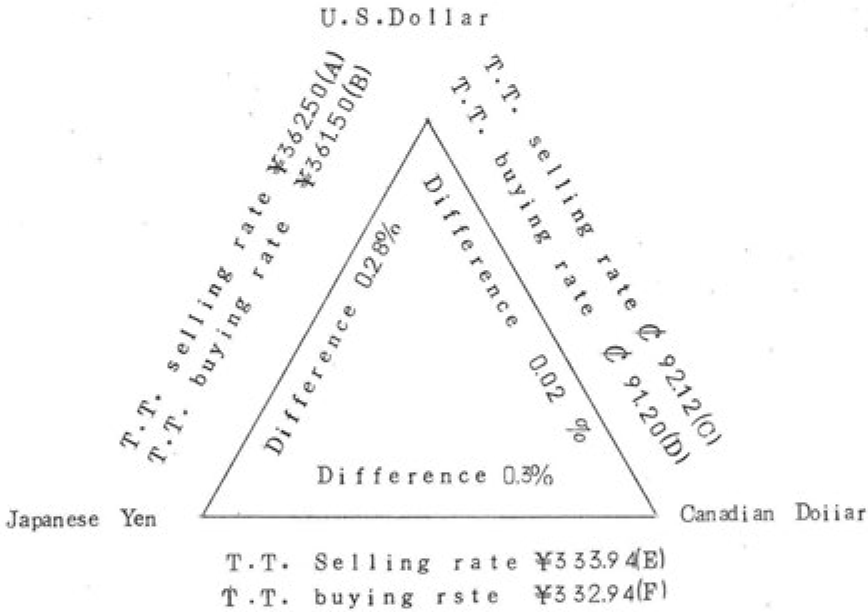
1. The four countries---Canada, Japan, Australia and New Zealand---make up for their shortages of external reserves under the clearing system. Table 4, in which the external reserves of the countries within the area are compared with those of the developed countries outside the area, shows that the reserves of the former countries are much smaller than those of the latter countries. If the four countries are allowed to use their own currencies for settlements within the area, they may economize their reserves so much.

Table 4. Ratios of Reserves to Imports ($\frac{\text{Reserves}}{\text{Imports}}$)

	1960	1961	1962	1963	1964	1965	1966	1967
United States	1.18	1.17	0.97	0.91	0.82	0.67	0.53	0.52
Canada	0.32	0.37	0.40	0.39	0.38	0.37	0.27	0.25
Japan	0.43	0.29	0.36	0.31	0.25	0.26	0.22	0.18
Australia	0.33	0.55	0.53	0.66	0.58	0.41	0.43	0.36
New Zealand	0.24	0.15	0.23	0.16	0.17	0.09	0.09	0.12
United Kingdom	0.29	0.26	0.26	0.23	0.15	0.19	0.19	0.16
F. R. Germany	0.70	0.65	0.57	0.59	0.54	0.42	0.45	0.47
France	0.36	0.50	0.54	0.56	0.57	0.61	0.57	0.62
Italy	0.69	0.73	0.67	0.48	0.53	0.65	0.57	0.58
Netherlands	0.41	0.38	0.36	0.35	0.33	0.32	0.31	0.31
Belgium	0.38	0.43	0.38	0.38	0.37	0.35	0.32	0.41
Switzerland	1.04	1.02	0.95	0.94	0.86	0.88	0.84	0.78

Source: International Financial Statistics, IMF.

2. Exchange rates between the currencies of the four countries will become advantageous to the parties concerned. In explaining this advantage in more detail, an example shall be taken from the exchange rate between the Japanese yen and the Canadian dollar, as quoted on January 29, 1968, by which time the dollar crisis seemed to have lulled and the exchange market conditions returned to normal. As the following Chart indicates, the exchange rate between the Japanese yen and the Canadian dollar is arbitrated between the exchange rate of the Japanese yen for the U.S. dollar and that of the Canadian dollar for the U.S. dollar. On January 29, 1968, T.T. selling rate for the U.S. dollar was quoted in Tokyo at ¥362.50 and T.T. buying rate at ¥361.50. In New York, T.T. selling rate for the Canadian dollar was quoted at U.S. ¢92.12 and T.T. buying rate at U.S. ¢91.20.



Japan's imports A X C = E

Japan's exports B X D = F

In the case of Japan's imports from Canada, the importer first buys U.S. dollars at the T.T. selling rate of ¥262.50 for the U.S. dollar and then buys Canadian dollars at the T.T. selling rate of U.S.¢92.12. The importer is thus subjected to relatively high rates of exchange as the following formula indicates and has to pay so much more.

¥362.50 x U.S.¢92.12 = ¥333.94

In the case of Japan's exports to Canada, on the other hand, net receipts of the exporter prove smaller than could otherwise be obtained. That is to say, the exporter first sells his Canadian dollars in exchange for U.S. dollars and then sells the U.S. dollars to obtain the Japanese yen. In this case, T.T. selling rates are applied to such sales to the disadvantage of the exporter.

¥361.50 x U.S.¢92.10 = ¥332.94

At the exchange rate between the Japanese yen and the Canadian dollar is not directly quoted, but arbitrated through the medium of U.S. dollars, differences between selling and buying rates are given at,

0.28 percent for Japanese yen-U.S. dollar rates
0.02 percent for U.S. dollar-Canadian dollar rates
0.3 percent for Canadian dollar-Japanese yen rates

Thus the difference between buying and selling rates of the Japanese yen for the Canadian dollar is made of similar difference between the Japanese yen and the U.S. dollar and that between the U.S. dollar and the Canadian dollar. Should exchange rates between the Japanese yen and the Canadian dollar are quoted directly, the difference would be reduced with 0.3 percent as its maximum.

If there was no difference in time between Tokyo and New York, the Japanese importer could buy

Canadian dollars at a rate more advantageous to him. In actual practice, however, a time lag of one day due to time difference is necessarily caused, and risks likely to incur during the day are wooven into the exchange rate, so much working against the interest of the importer.

3. If exchange rates are to be quoted directly between the countries within the area, they will prove ones that reflect more the economic conditions in the countries concerned that those quoted through the medium of U.S. dollars or pounds sterling. For instance, substantial fluctuations consequent upon instability in the strength of U.S. dollars and pounds sterling may be averted. It is only natural that so long as arbitration of exchange is conducted, exchange rates between certain two currencies should learn toward those quoted through the medium of U.S. dollars.

   But, when trade within the area expands, exchange rates reflecting the economic relations between the two counctries concerned will become more inducible and the lowest rates of exchange will be induced in that direction.

4. An exchange market for two currencies, if formed, will make easy operations in forward exchange rates, thereby serving to stabilize exchange rates at large. And if the spread between buying and selling rates is narrowed, exchange rates may be fluctuated for each of the two currencies within the limit of 2 percent above and below the parity registered at the International Monetary Fund.

5. If marketability is established for the currencies of the four countries within the area, the central banks will hold these currencies as the external reserves of the respective countries. Through the conclusion of swap arrangements among the five countries within the area, the five countries may provide against contingencies each other. In this way, as is the case with the European Economic Community, cooperation among the five countries is expected to proceed for the stabilization of their currencies.

6. Exchange operations are ample if settlement currencies are small in number, but conversely, those engaged in exchange operations will be favored with larger chances of getting advantages if such currencies are large in number. The exchange systems of today retain traces of controlled prices prevalent during the last war. It is desirable that exchange markets should have fields in which freer operations could be conducted extensively.

7. Finally, if the four currencies are used on top of the U.S. dollar, bear attacks likely to be launched on the dollar when it has run into a crisis, could be lessened. If the four countries hold U.S. dollars alone as their external reserves, any decline in the strength of the dollar that may result from selling attacks from continental Europe, for instance, will lead the four countries to sell dollars they hold, further aggravating the dollar uncertainty in consequence. Hence, if the five currencies are used and held as external reserves of the respective countries, bear attacks on the dollar with the aim of averting risks would be weakened.

V Capital of the Bank

Funds needed for operations of the Bank must be examined by dividing its activities into two sectors of investment accounts and settlement accounts.

In the investment account sector the Bank will not need any large amount of funds for its investments and loans out of the owned capital. For, as mentioned earlier, the major role of the Bank in the field of investments lies not in the use of its owned capital but in the facilitation of private capital investments of the five countries within the area.

As regards the settlement account sector, the Bank will have to meet cover requirements for the currencies of the five countries and extend loans of a temporary nature. The size of funds needed for these purposes is dependent on the ratios at which the five currencies are used respectively for settlements among the five countries and on the extent to which payments gaps among the five countries is widened. Although it is hard to estimate the relevant figures, capital needed by the Bank is put at U.S.$200 million on the basis of the following data.

Imports of the four countries from each other totaled $10,890 million in 1966, and their trade balances with each other came to a deficit of $1.73 million in the aggregate, which corresponded to 8 percent of the import total. On the assumption that the currencies of these four countries were used to pay for the imports, the import total is estimated at $2,481 million. Accordingly, an amount equivalent to 8 percent of this estimate, some $200 million, is considered the maximum one The Bank will have to hold as its reserves.

Table 5. Imports of Five Countries from Each Other in 1966 and Estimated Ratios at which their Respective Currencies are Used.

(in millions of U.S.dollars)

	United States	Canada	Japan	Australia	New Zealand	Imports as multiplied by ratios (excluding U.S.)
United States		4,857 (70%)	2,414 (90%)	313 (90%)	130 (90%)	
Canada	5,594 (30%)		212 (20%)	43 (20%)	13 (20%)	1,731
Japan	2,364 (10%)	335 (20%)		552 (20%)	61 (50%)	344
Australia	785 (10%)	135 (20%)	328 (20%)		50 (80%)	211
New Zealand	117 (10%)	40 (20%)	60 (50%)	181 (80%)		195
				Total		2,481

Source: Direction of Trade, I.M.F.

VI Future Role of the Bank

It is expected that the Bank will play many roles on top of its functions that will help solve the current problems. Of particular importance is that with the Bank as the center co-operation among the central banks and commercial banks of the five countries will be pushed forward. It is to be hoped that the Bank will assume features of the Bank for International Settlements for the central banks and those of the Pacific Bankers Association for the commercial banks.

With ties among the banks thus strengthened, long-term investments and loans will be facilitated more effectively and exchange uncertainty will be dissipated, and consequently operations of the settlement system for the countries within the area will be streamlined.

Mutual guarantee of gold value for the currencies by the respective central banks and expansion of swap arrangements will then be made possible. International financial cooperation will in turn be relieved from its current crisis and greatly bolstered through the promotion of regional financial cooperation.

SESSION V

Comment on R. N. Cooper's Paper by Motoro Kaji

Prof. Cooper's paper is concerned with the main subject of this conference --- it presents a most thorough study of the financial problems of closer Pacific economic co-operation.

By way of introduction, Prof. Cooper suggested three justifications for closer economic co-operation; (1) that it should lead to improved allocative ameliorate efficiency, (2) that it should overcome difficulties in international payments, (3) that it should facilitate adjustments by over-valued currency countries. Then he asked three questions: (1) Is there any basis for regional arrangements among Pacific basin countries? (2) Do the five Pacific basin countries constitute the best group for integration? (3) Would all participants find it in their long run political interest to join such a regional group? In the remainder of his paper, Prof. Cooper sets out his answers to these questions.

In general, he believes that the establishment of a Free Investment Area would be beneficial. Though he is generally skeptical about the feasibility of a Free Trade Area, he does suggest that the trade creation-trade diversion criteria probably support its establishment. I would rather emphasize the difference in industrial structures among the five countries. Prof. Cooper treats them all as industrialized countries. There is no doubt that they are all industrialized relative to less developed countries but the degree of industrialization in each is different. I am not sure whether this observation tends to qualify Prof. Cooper's conclusions.

As to the balance of payments question, Prof. Cooper has provided a practical proposal. He suggests the establishment of a reserve pooling arrangement among the five Pacific basin countries. His empirical study of the relation between reserve movements in Pacific countries provides support for these proposals. He found high negative correlation coefficients in four cases out of ten. And he concludes that the benefits of reserve pooling might be significant in those cases.

Although I agree with his conclusions, I am not fully prepared to accept his proposal for reserve pooling. Prof. Cooper assumes that countries hold international reserves primarily to settle occasional international deficits. This assumption is probably not reasonable for the United States whose currency is used as international liquidity. Moreover, her balance of payments has been in deficit for almost the entire period which Prof. Cooper analysed. Taking these facts into consideration, it seems doubtful to me that any country would be willing to join in reserve pooling with the United States even if reserves move inversly with those of the United States.

As to his final point about the formation of discriminatory economic blocs, I would like to emphasize one thing --- that is, the importance of Japan's economic relations with South East Asia. Prof. Cooper pointed out that the United States could not exclude Latin American countries from any arrangement. Japan's position in Asia is somewhat similar to the United States' position in the Western Hemisphere.

Comment on E. Ashiya's Paper by Harry G. Johnson

Prof. Cooper has given us an extremely lucid survey of the various aspects that economic co-operation in the Pacific Region could take, and has dwelt particularly on the general possibilities of co-operation with respect to international monetary arrangements and international capital movements; Prof. Ashiya's paper complements Prof. Cooper's very well, by proposing the creation of a new international banking institution --- A Pacific Bank for Investments and Settlements --- through which these possibilities of co-operation could be realized, and by examining the characteristics that such a Bank should have and the problems that its creation would leave unsolved.

I must confess, however, that I had some difficulty in understanding exactly what problem Ashiya's Bank is intended to solve. The reason, so far as I can determine, is that Prof. Ashiya's proposals build on a prior analysis by Prof. Kojima, which analysis is not made explicit in Prof. Ashiya's paper. At two points in his paper (p.307 and p.321) it is stated that the function of the Bank as an investment mechanism is "based on the concept of "Lent Currency" worked out by Prof. Kojima and the idea of "Pacific Dollars" proposed in the constitution of the Bank. Neither of these concepts is explained in the paper, and I cannot see that the proposed investment activities of the Bank really imply them. On the contrary, these activities seem different from what one would propose if one were asked to suggest the activities that a government supported investment bank might undertake in the Asian region. However, the concept of the "Pacific Dollar", if I have rightly inferred its nature from its name, does appear implicitly and misleadingly in the advantages cited for the settlement operations of the bank. Advantages (6), (7) and (8), concern the use by outside developed countries of the currencies of the five Pacific countries and the consequent economization of foreign exchange reserves, could conceivably be realized if a single strong currency for the Pacific region were developed, supported by requisite commercial and financial institutions, and useful enough in world trade and payments to take over the commercial and financial role of sterling and possibly the dollar. But it seems very unlikely indeed that the Bank's operations in the five separate currencies, as outlined in the paper, would be sufficient to establish for the four other than the dollar, a role as an internationally usable currency.

It would probably be most helpful to the discussion if in my comment I attempted to restate what the main functions of the proposed Bank are intended to be, and comment on them. It is assumed that the main function of the international monetary system will remain unchanged, and that the Bank will work within that framework. It will then have three major, and separable, functions.

The first of these functions is to improve what Prof. Ashiya calls the marketability of the currencies and the stability of their exchange rates. "Stability" is a rather puzzling term, since all the countries involved have fixed exchange rates in the IMF system. What Prof. Ashiya has in mind seems to be that the currencies of the area do not exchange directly against each other in the market, but are exchanged on the basis of cross-rates on the pound or the dollar; and that this involves both additional commission costs, and additional uncertainty. The proposal is that the Bank should make a market for the commercial banks in each of the countries, for the exchange of the currencies directly for one another, and in so doing should reduce fluctuations of rates. This operation would be undertaken on the strength of commitments by the various central banks to supply their currencies for its operation.

The proposal of this function raises three questions in my mind. The first is whether, the extra costs of conducting trade between Pacific countries by means of such currencies are really important enough to inhibit such trade. I would judge from the other papers and the discussion that they are not, and that instead the main inhibitions on the development of intra-Pacific trade are traditionally political, cultural, and economic ties with countries outside the region --- specifically with the United Kingdom. The second is whether the Bank would be able to achieve such improvement in the stability of rates and lowering of costs if it were to operate in the terms suggested. The third question is whether stabilization of rates and narrowing of dealer's margins are desirable: these phenomena provide the profit incentive for commercial banks and others, industry speculators, to make a private market in these currencies, so that the Bank might achieve the objectives set only by itself becoming the market.

The second function of the Bank would be to provide a settlement mechanism, both among the five developed countries of the Pacific Region, and between them and the Asian developing countries and among the latter, thus permitting economies in the holding of gold and reserve currencies other than the dollar. As Prof. Cooper's interesting use of covariance analysis shows, substantial economies in reserve holdings could be achieved by pooling among the five countries, however, these gains are in fact already largely realized under existing arrangements. There might, moreover, be a problem, of which Prof. Ashiya is aware, in that one member --- probably under present circumstances the United States --- might exploit the settlement arrangement to finance a sustained balance of payments deficits. With respect to the developing countries, it would, as Prof. Ashiya recognizes, be necessary to make provision to prevent such countries from financing their chronic balance of payments deficits through the accumulation of their currencies in the Bank.

The third function of the Bank would be to provide short-term and long-term financing for development, using funds attracted from both public and private sources. This function raises two general problems. The first, which is not discussed in the paper, is how the Bank's operations would dovetail with the operation of the Asian Development Bank, not to speak of the other existing agencies for financing development.

The second question is raised by all three of the proposed functions of the Bank. Prof. Ashiya asserts at the outset of his proposal that the Bank should be a private institution but receive assistance from governments, and particularly central banks. It is not clear from the description whether the Bank is to be essentially a profit-making institution, or a public non-profit corporation, receiving public subsidies to enable it to carry on its work. The description of its investment activities implies that it is intended to be profit-making; if so, then the question is whether the proposed investment operations can be carried on at a profit sufficient to attract the private funds expected. Both the function of improving the foreign exchange market for four of the five currencies, and the provision of a settlement mechanism, do not appear at first sight to promise a gratifying rate of profit. Hence it appears that a subsidized public corporation would be necessary for these two functions, and also for the investment operations to the extent that these are envisaged as subsidizing development in the developing countries.

On balance, I am inclined to take the view that the proposed Bank is being charged with too many disparate functions, and that the foreign exchange market-making and the settlement functions would be better handled by agreement among the central banks to deal in and hold each others' currencies, while the investment function should be performed by non-profit corporation if the intention is to use primarily public funds, or by a government-guaranteed private profit-making corporation, if the intention is to use primarily funds borrowed from private sources.

In conclusion, there are some details of the paper that I do not understand. On p.308, there is no description of the figures presented --- presumably they are ratios of reserves to some trade magnitude --- and the interpretation of them should recognize that the four countries for various reasons can manage with smaller reserves than European countries, either because they have access to the US capital market or because they rely on the use of controls to an unusual extent. On p.320, para 3, the requirement of debtors to pay in currencies other than dollars does not make sense, the amendment from "required" to "allowed" leaves matters still in doubt, since in a convertible currency system debtors could always convert other currencies into one of the five. On p. 321, point (2), the point about the interest burden and the lessening of it by greater speed in settlement needs elaboration; typically delay in settlement merely transfers interest earning from the lender to the borrower. Finally, on p. 322, I cannot replicate the process by which the data on p.323 yield an estimate of $200 million for the capital required for the settlement account of the Bank.

Discussion on Cooper's and Ashiya's Papers

In reply Prof. Cooper took up three points raised by Prof. Kaji.

He admitted that there was considerable heterogeneity in the industrial structures and economic performance of the five advanced Pacific countries, but he could not see why this would militate against effective integration. On the contrary, it could be argued that heterogeneity would provide a basis for effective integration for number of reasons. For example, the free movement of diverse factors of production and knowledge have been stressed elsewhere.

He explained that the correlation coefficients related to movements in reserves and not the absolute level of reserves and that conclusions about the desirability of reserve pooling could be made on this basis. For example, there were highly negative correlations between movements in Japanese and Australian reserves, and United States and Japanese reserves, as might be excepted from the close trade relations between each pair of countries, and a positive correlation between movements in Australian and United States reserves.

Though Prof. Kaji's final comment implies criticism of regional arrangements on the ground of the different trading interests of partner countries, Prof. Cooper suggested that there might still be a basis for beneficial discrimination in capital transactions. So far the United States has resisted the temptation to implement trade restrictions, except in special procurements. Although the distinction between merchandize and capital transactions is increasingly difficult to draw, some regional arrangement might effectively maintain access to the United States capital market for Asian - Pacific countries.

In reply to Prof. Johnson's comments, Prof. Ashiya made the following points.

The virtues of a single currency system, the retention of which Prof. Johnson appears to advocate, are open to serious question. Such a system required sppropriate adjustments of monetary and fiscal policy which, as is demonstrated in the case of EEC, are difficult to realize.

Cross-exchange transactions <u>are</u> costly and risky. The object of the PBIS would be partly to provide a cover for exchange risks in dealing in the four lesser currencies.

Under the present system, central banks have no particular incentive to lessen exchange instability, except within the IMF framework. Since they prefer to hold US dollars as their reserve currency, this is likely to remain so.

The cost involved in cross-exchange operations to finance Pacific area trade might seem marginal. But profit margins on foreign trade are so narrow that even small economies in exchange costs could help to expand trade. Moreover, under the present system, trade, for example between Australia and Japan, has to be settled in pounds sterling, and instability in cross-rates among the four lesser currencies reduces rather than improves the effectiveness of the exchange market and provides the wrong profit signals.

As pointed out in the original paper, the exchange rate between the US dollar and Japanese yen, for example, is disadvantageous in terms of market returns (See revised text, p. 319).

The Asian Development Bank and similar organizations promote inter-governmental financing of development. The PBIS is designed to promote private capital flows.

Whilst it is true that the operations of the PBIS would not to be so profitable as normal commercial banking operations, commercial banks would benefit from the increased marketability of member countries currencies and thus have an incentive to become involved in the operations of the Bank.

Finally, only two main functions are suggested for the PBIS. i) an improved payments system, and ii) a more efficient investment institution. The system of payments suggested would become unnecessary when the currencies of the five countries achieved marketability and stability so that commercial banks could then handle payments in the currencies of the five countries.

Discussion of Prof. Cooper's paper focussed on the United States attitude toward trade liberalization on a regional basis. Canadian and Australian participants stressed the importance of keeping the United States interested in liberalization. American participants argued that another Kennedy Round was still possible, although there must be some interval in which the results of the current round can be digested. They also stressed the impossibility of American participation in regional arrangements which did not accommodate Latin American interests and, therefore, the superiority of generalized tariff preferences for less developed countries.

Other participants, especially from Canada and Australia, stressed the urgency of new approaches to trade liberalization from the viewpoint of smaller Pacific economies. They were anxious that opportunities for more effective industrial specialisation be pressed. They saw little likelihood that future multilateral liberalization would produce significant benefits for these economies.

Discussion of Prof. Ashiya's paper centered on the three major functions of the Bank specified by Prof. Johnson.

There was some doubt about the importance of additional costs because of exchange transactions among the four lesser currencies via London or New York. Prof. Ashiya and others suggested that these costs were significant.

It was also argued that co-operation among Pacific country central banks serves the settlement function of the proposed Bank reasonably well.

Moreover, it was pointed out that Japan, the United States, Australia and New Zealand were all committed to the Asian Development Bank which could serve the investment function of the proposed Bank more effectively. Prof. Ashiya emphasized, however, that the PBIS would be a private institution designed to promote the flow of private investment funds.

Chapter 11 U.S. AID POLICIES IN ASIA

by Gustav Ranis
Professor, Yale University

There can be little room for doubt, now less than ever before, that Asia as defined--necessarily arbitrarily--by ECAFE occupies a very important place in U.S. foreign policy--perhaps second only to Latin America in terms of any hierarchy of priority regions. Moreover, foreign assistance is well-recognized as one of the more important tools of foreign policy, in the U.S. as elsewhere. It should therefore not be surprising that the U.S. has spent more money on foreign assistance in Asia than in any other part of the less developed world since the end of World War II. Even on a per capita basis, the aid levels in this most densely populated of all aided regions exceeded those anywhere else until the Alliance for Progress came into being in the early 1960's. Yet looking beyond this continuing affirmation of the importance of the Region to the U.S. national interest, what is really most striking is the diversity of major U.S. objectives in Asia and, consequently, of the aid effort itself over time. To help us demonstrate this central fact, we shall find it convenient to engage in some analysis of the nature of the past U.S. and presence in that part of the world before dealing with present-day policies and likely future emphases which I take to be the main assignment of this paper.

I It surely must be clear to even the most casual observer that the U.S. has a variety of major objectives in its aid programs in Asia--as elsewhere--and that to treat the program as a monolithic whole would be extremely misleading. This is true both historically and in the contemporary context. While the number of all the relevant objectives that might be cited is large in number, the countries of the region can be divided reasonably into at least two major groups: a group in which objectives of security and stability are of over-riding importance, and a group in which objectives of economic and social development are paramount.

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Most of Asia lies at the periphery of the Communist bloc. As the U.S. redirected its global post-Korea aid effort towards the less developed countries, there can be little doubt that continuing competition with the Communist bloc played a major role in both size and orientation of the effort. It is, moreover, important to differentiate between those countries at the periphery of the Communist bloc in which the East-West confrontation of the early fifties basically took on the form of an actual or threatened renewal of armed conflict--and those in which it exhibited itself through competitive systems, aided by competitive donors, trying to achieve economic development. It should, in other words, be quite clear that U.S. aid programs in such countries as Korea, Taiwan and Vietnam, were heavily dominated by the military confrontation of the early post-Korean period, and that the assistance to such countries as India, Pakistan, Ceylon and the Philippines was premised differently, i.e., on the more peaceful type of confrontation between competitive economic systems.

In table I we present the total U.S. aid program in '53-'59, both on an overall basis and separately, for the major security/stability and development objective countries. The table permits us to observe that while almost 79% of the total was made up of economic aid (A.I.D. predecessors plus agricultural commodities under P.L. 480), the proportion of military assistance in the total is much higher in the case of the major security-stability objective countries (41.4%) than for the major development objective countries (8.5%). We all recognize, of course, that resources are "fungible" and that the provision of military assistance to one country (e.g., Pakistan) and the provision of economic assistance to another, (e.g., India), enabling the first to purchase economic and the second military equipment on the open market, may work out to have a similar impact on total resources available and their allocation. Nevertheless, we should be clear about the fact that, in the real world, fungibility is, in fact, not complete, especially when the foreign assistance is substantial in size relative to a country's total foreign exchange resources and/or when the relations between recipient and donor are close and run the entire gamut of allocative decision-making in the host government. Decisions as to what type of assistance to provide and what type to refuse-- within a given overall total for that country--are, in such cases, likely to have a substantial impact not only on the recipient's allocation of total available foreign exchange resources but also--and often more import-

TABLE IA

U.S. Aid Program in Asia[1] 1953-59
(in millions of dollars)

	Total Aid	Economic Aid[2]	% of Total	P.L. 480	% of Total	Military	% of Total
U.S. Aid Program							
Eastern ECAFE							
Burma	95.9	68.9	71.8	27.0	28.2	--	--
Cambodia	232.8	173.6	74.7	2.3	1.0	56.4	24.3
Indonesia	298.6	194.6	65.2	93.1	31.2	10.9	3.7
Korea	3,365.6	2,087.5	62.0	228.7	6.8	1,049.4	31.2
Laos	236.4	191.0	80.8	.8	.3	44.6	18.9
Philippines	487.5	296.7	60.8	30.0	6.2	160.8	33.0
Taiwan	2,368.0	728.3	30.8	59.2	2.5	1,500.5	66.7
Thailand	461.9	217.0	47.0	2.1	.4	242.0	52.6
Vietnam	1,647.5	1,219.1	74.0	55.5	3.4	372.9	22.6
Western ECAFE							
Afghanistan	126.1	105.5	83.7	20.4	16.2	.2	.2
Ceylon	89.2	53.5	60.0	35.7	40.0	--	--
Iran	779.5	465.6	59.7	16.1	2.1	297.8	38.2
India	2,026.9[3]	1,374.0	67.8[3]	652.9	32.2[3]	364.8[4]	6.7[5]
Pakistan	3,060.9[3]	954.0	31.2[3]	2,106.9	68.8[3]		
Total (including military)	15,641.1	8,129.3	52.0	3,330.7	21.3	4,181.1	26.7

[1] The definition of Asia here follows that used by ECAFE. Source: U.S. Overseas Loans and Grants and Assistance from International Organizations, Obligations and Loan Authorizations, Agency for International Development, Office of Program Coordination, March 17, 1967.

[2]Mainly AID/ predecessors, not assistance transferred through the World Bank family, the U.N. family, or contributions to the equity of the Asian Development Bank.

[3]Excluding Military

[4]Only total for both available due to classification.

[5]For both countries if military is included.

TABLE IB

U.S. Aid Program in Asia 1953-59
(in millions of dollars)

	Total Aid	Economic Aid	% of Total	P.L. 480	% of Total	Military	% of Total
Major Security-Stability Countries							
Korea	3,365.6	2,087.5	62.0	228.7	6.8	1,049.4	31.2
Taiwan	2,368.0	728.3	30.8	59.2	2.5	1,580.5	66.7
Vietnam	1,647.5	1,219.1	74.0	55.5	3.4	372.9	22.6
Thailand	461.9	217.0	47.0	2.1	.4	242.8	52.6
Total	7,843.0	4,251.9	54.2	345.5	4.4	3,245.6	41.4
Major Development Countries							
India	2,026.9*	1,374.0	67.8*	652.9	32.2*	) 364.8** **)	6.7***
Pakistan	3,060.9*	954.0	31.2*	2,106.9	68.8*		
Ceylon	89.2	53.5	60.0	35.7	40.0	--	--
Afghanistan	126.1	105.5	83.7	20.4	16.2	.2	.2
Philippines	487.5	296.7	60.8	30.0	6.2	160.8	33.0
Total (including military)	6,155.4	2,783.7	45.2	2,845.9	46.2	525.8	8.5

* Excluding military
** Only total available due to classification
*** For both countries, if military is included.

antly--the recipient's use of complementary domestic resources. In fact, the only way we could tell precisely what the impact of a given level and composition of any aid package has been is if we knew what the recipient would, in fact, have tried to do in the absence of foreign assistance. Only then could we be sure of how the additional capacity to allocate resources embodied in the foreign assistance package was utilized. Such comparative analysis of the real impact of the U.S. aid programs in India and Pakistan, for example, would certainly be appropriate, if difficult to execute.

In the countries of the first group, i.e., those in which the U.S. was concerned primarily with assuring a minimum level of stability under the protective umbrella of a military establishment capable of repelling overt communist agression or covert infiltration, aid policies concentrated on the provision of a substantial volume of military equipment and technical assistance for the indigenous forces as well as on building the economic and social infrastructure capable of sustaining the host governments' own defense effort. While it is difficult to generalize either for all countries in this category or for the entire period of the 1950's, the objective was one of assuring the survival of society, first, and getting it back on the rails of social and economic growth, second. On the other hand, in the countries in which there was no clear and present military threat U.S. policy concentrated on generating, together with the recipient, that volume of domestic and foreign resources and that agreement on policy actions intended to bring the economy out of stagnation and into a situation of self-sustaining growth. To bring this down to an individual country context, this meant that while, in Korea and Taiwan, we were concerned mainly with an overt military threat, --and in vietnam and Laos with the threat of infiltration and insurgency --support for the five year development plans of India and Pakistan, intended to put such economies in a position where they could stand--and grow--on their own, went ahead with equal vigor. It is, in fact, clear that as the attention of the U.S. government shifted from Europe to the rest of the world the realization that development is the prime moving force which must be respond to became more and more wide spread. Moreover, it became clearer that substantial capital transfers --combined appropriately with the technical assistance of the early Point Four period-- were required if the resource requirements consistent with minimum growth targets were to be met.

Moving on to developments in the early 60's, we may note a number of major events changing the structure of the U.S. aid program in Asia, as a direct result of changes in the situation facing a number of the recipient countries in that part of the world. Table II presents both the overall picture and the aid allocation in some of the important countries in the region. The overall rise in the relative importance of economic assistance, including P.L. 480, must be noted. With respect to individual countries, perhaps the most remarkable shift is the graduation of Taiwan from a stability/security case to a developmental case. This transition began in the late 50's and had its full bloom in the early 60's. We are all aware of the tremendous performance of the Taiwanese economy after 1960 when a substantial volume of economic assistance (see table II) was dove-tailed with a sustained domestic effort, including major economic policy changes within the Taiwanese economy. The policy package adopted included a substantial land reform, import liberalization via a loosening of the import control system, devaluation and fiscal and monetary reforms. This paper is not the appropriate place for a detailed discussion of the famous Taiwanese "success story" ; suffice it to say that the substantial bulge of U.S. foreign assistance in the early 1960's enabled--and embloldered--the Taiwanese to take those measures which, by 1965, had in turn put the economy in a position to move forward without any further substantial concessional assistance from the U.S. Table III provides us with an indication of the impact of these post-1961 policy changes, as domestic saving and private foreign capital displaced foreign aid and permitted Taiwan to "graduate" from the roll of aid recipients by the mid 60's.

A second notable change in comparing country situations in the 60's with the 50's is the remarkable shift of Korea from a seemingly perennial security/stability ward of the U.S. to one of the most promising developmental cases anywhere. It should be noted, for example, that Korea's domestic savings rates which were negative less than five years ago, are now exceeding twelve percent, that exports, which were virtually stagnant, are now growing at astronomic rates, i.e., in excess of 30 percent a year. Transformation here again was in two steps, first a transition to development objectives, and, second, moving from short-run stabilization to a point where self-sustaining growth is in reach, as a consequence of sizeable aid inflows, coupled with major revisions in public policy. Korea revised her exchange rate, dismantled many of her quantitative

TABLE IIA

U.S. Aid Program in Asia[1] 1960-66
(in millions of dollars)

U.S. Aid Program	Total Aid	Economic Aid[2]	% of Total	P.L. 480	% of Total	Military	% of Total
Eastern ECAFE							
Burma	25.5	16.6	65.1	8.9	34.9	--	--
Cambodia	111.4	80.1	71.9	.5	.4	30.8	27.6
Indonesia	520.5	302.0	58.0	170.0	32.7	48.5	9.3
Korea	3,173.2	1,505.6	47.4	523.9	16.5	1,143.7	36.0
Laos	369.8	282.5	76.4	3.4	.9	83.9	22.7
Philippines	519.5	294.1	56.6	81.9	15.8	143.5	27.6
Taiwan	1,528.1	562.0	36.8	281.6	18.4	684.5	44.8
Thailand	525.8	236.9	45.1	2.9	.6	286.0	54.4
Vietnam	3,346.0	1,853.2	55.4	347.9	10.4	1,144.9	34.2
Western ECAFE							
Afghanistan	310.3	216.3	69.7	91.6	29.5	2.4	.8
Ceylon	83.9	48.1	57.3	35.8	42.7	--	--
Iran	815.1	349.0	42.8	106.6	13.1	359.5	44.1
India	7,780.2[3]	5,106.6	65.6[3]	2,673.6	34.4[3]	) 417.0[4]	) 4.5[5]
Pakistan	1,112.4[3]	297.5	26.7[3]	814.9	73.3[3]		
Total (including military)	20,638.7	11,150.5	54.0	5,143.5	24.9	4,344.7	21.1

[1]The definition of Asia here follows that used by ECAFE. Source: U.S. Overseas Loans and Grants and Assistance from International Organizations, Obligations and Loan Authorizations, Agency for International Development, Office of Program Coordination, March 17, 1967.

[2] Mainly AID/predecessors, not assistance transferred through the World Bank family, the U.N. family, or contributions to the equity of the Asian Development Bank.

[3] Excluding Military

[4] Only total for both available due to classification.

[5] For both countries if military is included.

TABLE IIB

U.S. Aid Program in Asia 1960-66
(in millions of dollars)

	Total Aid	Economic Aid	% of Total	P.L. 480	% of Total	Military	% of Total
Major Security-Stability Countries							
Vietnam	3,346.0	1,853.2	55.4	347.9	10.4	1,144.9	34.2
Thailand	525.8	236.9	45.1	2.9	.6	286.0	54.4
Total	3,871.8	2,090.1	54.0	350.8	9.7	1,430.9	37.0
Major Development Countries							
Korea	3,173.2	1,505.6	47.4	523.9	16.5	1,143.7	36.0
Taiwan	1,528.1	562.0	36.8	281.6	18.4	684.5	44.8
India	7,780.2*	5,108.6	65.6*	2,673.6	34.3*	) 417.0**	) 4.5***
Pakistan	1,112.4	297.5	26.7*	814.9	73.2*		
Ceylon	83.9	48.1	57.3	35.8	42.7	--	--
Afghanistan	310.3	216.3	69.7	91.6	29.5	2.4	.8
Philippines	519.5	294.1	56.6	81.9	15.8	143.5	27.6
Total (including military)	14,924.6	8,030.2	53.8	4,503.3	30.2	2,391.1	16.0

* Excluding Military
** Only total available due to classification
*** For both countries, if military is included.

controls, took a new, more forthcoming, posture towards her Japanese neighbor, reformed her industrial structure and monetary policy in general and began to grow rapidly for the first time since World War II.

What happened in both Taiwan and Korea was that once minimal security had been assured and markets activated as a result of a successful government stabilization and liberalization effort, the interplay of individual profit maximizing decision-makers could move the system forward, with foreign aid providing the buffer for additional import requirements and assuaging the fears of policy makers as to the "drain of resources" which might accompany such change. Once markets are activated and substantial new domestic resources come into play as domestic entrepreneurs begin to spend their efforts on productive tasks rather than on trying to out-guess and outsmart the control system, foreign capital is likely to follow.

With respect to India and Pakistan, the U.S. has recognized in the past that these two countries can be said to represent the free world's major developmental challenge in Asia. Consequently as tables I and II indicate, the U.S. has mounted substantial aid efforts there over the years, with military assistance a somewhat larger proportion of the total in Pakistan and economic assistance more important in India. Moreover, acting through its aid missions and via multi-donor consortia of the world bank, the U.S. has tried to do more than simply allocate its resources in support of the Sub-continent's development programs; it has tried--and not always with complete success--to maximize the catalytic value of the aid relationship. While a detailed analysis of this relationship would take us too far afield, it is now generally accepted that the hammering out of agreement on a policy package comprementary to the aid package enhances the opportunity to do more than simply provide additional resources via foreign assistance. Measures taken by the Government of Pakistan after 1961, for instance, including import liberalization, the restoration of market-determined prices of the major crops and a substantial devaluation of the currency through the institution of an export bonus system, were arrived at after years of mutual discussion and negotiation. It is now clear that these measures succeeded in moving the economy in the direction of harnessing the medium-sized entrepreneur and landlord class to the developmental effort. The usual performance indicators show that the Pakistan economy which was virtually standing still—without

TABLE III

Taiwan

Private Foreign Capital Flows, Gross U.S. Aid Flows, and Domestic Savings Rates (Public and Private)

	1957	1958	1959	1960	1961	1962	1963
Private Foreign Capital % of GNP	0.9	3.7	2.2	3.1	3.0	1.7	2.1
Gross U.S. Economic Aid % of GNP	10.4	8.5	7.3	7.3	7.2	4.5	3.9
Domestic Saving % of GNP	13.9	16.8	17.0	19.3	20.1	17.9	20.6
of which							
Private Domestic Savings % of GNP	4.6	7.3	8.4	9.9	11.4	12.2	14.4
Public Domestic Savings % of GNP	9.3	9.5	8.6	9.4	8.7	5.7	6.2

any substantial growth of output per head during the late 1950's --turned around dramatically in the 1960's with per capita incomes rising at 2-3 percent a year, largely as a consequence of a substantial spurt in the agricultural sector which had been virtually stagnant in the earlier period. The increase in agricultural output at 5% or thereabouts in both wings of Pakistan in recent years--an increase, incidentally, sustained even in the aftermath of the Indo-Pakistan war and the more recent bad monsoons--represents as dramatic a turnabout in an economy's basic economic landscape as has been witnessed in recent years. Commodity aid to buffer import liberalization and P.L. 480 food to buffer fluctuations around the new--and higher--level of crop prices illustrate the role foreign aid can play in inducing a government to take some rather courageous steps, and in supporting those steps, once taken thereafter.

India, on the other hand, traditionally more doctrinaire with respect to its view of the proper role of the market and government, has been slower to accept the notion that a more effective developmental program requires the participation of millions of the relatively, forgotten decision-makers in agriculture and in small industry--and that furthermore, such participation is very difficult to achieve through the best intentioned governmental programs acting alone. The most effective coordinating and propelling device known to man--aside from coercion which is rejected in most parts of Asia--is the reaction of individuals acting in their own self-interest to signals of the market place. Where these signals are imperfect and --as they often are in the less developed world blurred the government has a role to play in perfecting such markets. But an increasing number of aid recipients are coming to the realization each year that the most intelligent and enlightened civil service does not have enough administrative capacity to substitute for millions of market-oriented decision making units. About eighteen months ago the Indian Government also decided to embark on a thorough-going policy change including a major devaluation-cum-import liberalization package negotiated with the IMF, the IBRD and the international community represented by the India Aid Consortium. The results of the adoption of this policy package are not as yet as dramatically evident as was the case in Pakistan some five years earlier, but there is general agreement among the experts that the unhappy timing of the recent bad monsoons has served to mask the underlying positive structural changes which rendered the economy more flexible, more receptive to competitive stimuli from inside and abroad, and more capable of moving forward in a sustained fashion over time. It is certainly the expectation of the World Bank and the international community of experts that the Indian economy is now in a position to break out of its post-war stagnation. The removal of food zones in Indian agriculture and the attempt to continue the liberalization drive, especially in capital goods imports, should render growth rates of three to four percent annually feasible at response to levels of foreign assistance and would serve to provide a viable foil for the Chinese experiment on the other side of the bamboo curtain. It should be noted in passing that the early enthusiasm for that Chinese experiment, based on the Chino-India comparisons of the 50's, has been waning in recent years and that the Sub-continent has every chance to do substantially better than a system which must continue to harness the actions of millions of cultivators through a mixture of coercion and party discipline.

While Korea and Taiwan are typical of countries able to switch from a security/stability to a developmental emphasis, this is unfortunately not true for Southeast Asia. Thailand, for example, enjoying 6 percent annual growth rates spurred by its own agricultural sector and the help of foreign commercial capital, which by virtually any set of economic criteria should have been ready for graduation from aid years ago, has more recently become the object of Communist infiltration a la early Vietnam. As a consequence, the U.S. aid effort in Thailand, instead of tapering off, has increased, with a growing emphasis on the northeast region, the area most vulnerable to infiltration. Moreover, it will surprise no one that the aid program in Vietnam itself has been increasingly directed to the economic support of the overall U.S. war effort there, specifically rural pacification and other counter-insurgency programs, and that the waging of the "other war" in Vietnam has been subject to considerable constraints as long as a major shooting war remains in progress. Thus the shadow over South-East Asia has certainly had the effect of postponing the hoped for shift in foreign aid objectives in that part of Asia.

II Turning now to present U.S. aid policies and reasonable expectations about the future, we cannot, once again--and in all candor--ignore the immediate importance of the Vietnam conflict. Any single country program which provides aid levels in excess of $40 per head and takes up nearly one quarter of a declining world-wide foreign assistance availability cannot fail to have its impact, in the simple resources sense, on other things the U.S. is trying to accomplish in that part of the world. Moreover, the quality of our effort everywhere, the energies and attention span available for worrying about the tasks of development, are surely adversely affected. It would therefore be naive to argue that current U.S. foreign policy purposes, in general, as well as the catalytic uses of aid, in particular, are not profoundly affected by the confrontation now taking place in South-East Asia. The fate of the current aid bill, if nothing else, illustrates the existence of a constrained optimization problem in Asia--and elsewhere--for the duration of the armed conflict.

Nevertheless, it would also be a serious mistake to assume that the U.S. has become so preoccupied with Vietnam and so squeezed in terms of the resources available for foreign assistance, that we have lost sight of the overriding long term objectives of our foreign policy in Asia. In spite of Vietnam, the Executive Branch, at least, proposed a total foreign assistance effort (including AID, P.L. 480, support for regional banks, etc.) for calendar year 1968 in excess of any previous level since the Marshall Plan days. Actual commitments for all foreign assistance was in the neighborhood of 6 billion last year. In spite of our present Vietnam and balance of payments -dictated difficulties and frustrations, I am convinced we will not withdraw but stay the course in the foreign assistance arena. Moreover, rather remarkable changes in the landscape of development are presently being recorded which are bound to have substantial significance for the future. Our understanding of the growth process and of what needs to be done jointly with the recipient to further it has matured by leaps and bounds in recent years. We have, for example, a much better idea now, than ever before, of the importance of viewing the typical less developed economy as a multi-sectoral organism, with the focus on achieving a smooth mutually re-enforcing inter-action among the sectors. Only as we are able to determine which sector, ideally, fuels development elsewhere and what the bottlenecks are preventing such an ideal functioning of the system, can we be sure that resources and energies--including those included in the foreign assistance package--are being properly focused at the sectoral, as well as at the aggregative level. It is this type of realization which has led us increasingly to concentrate on ensuring the participation of millions of hitherto neglected decision-makers in the development process by focusing on the agricultural sector and on the "starved" medium-scale entrepreneurs outside of agriculture--while endeavoring to curb the number of new claimants to resources via voluntary population control programs.

Even in the war zone itself, the President in his speech at Johns Hopkins in 1965 made it abundantly clear that, while we look for opportunities to do what we can now, we shall be ready on a large scale to respond to the needs of development and nation-building in post-war Southeast Asia. Thus, as in Korea earlier, we are entitled to look beyond the present, to the day when the guns fall silent in South-East Asia. There are several major components of the U.S. policy framework of particular applicability to this Region which should be cited here.

First of all, we recognize the importance of the area by our awareness--even at a time of ever tighter appropriations--of new and important foreign assistance opportunities in this part of the world. While budgetary cuts are forcing considerable retrenchment in Africa and making it difficult for us to maintain the critical minimum aid levels in India and Pakistan, we are, nevertheless, trying to take advantage of the changed situation which has recently presented itself in Indonesia and may yet fully present itself in the Philippines. Taking Indonesia as an example, here is a country with admittedly great potential wealth which has for decades been unable to harness its resources for successful breakout from stagnation--in large part due to mistaken policies during the Sukarno period. The U.S. has declared itself willing, in concert with others, to support the current Indonesia stabilization effort and, more importantly, to assist the development effort which is concomitantly getting underway. Likewise, in the Philippines, plagued for many years by an inadequate willingness to make some rather radical adjustments in the structure of economic and political decision making in the country. We are thus willing, in concert with others, to resume aid programs--and thus make new investments in South-East Asia--even as older investments, e.g., in the Sub-continent, are threatened by budgetary tightness.

In resuming such development-oriented aid programs, as well as in continuing others at critically reduced levels, it is clear that the U.S. wants to act in concert with other aid-giving countries, such as Japan. This is true not only in terms of sharing the burden of resources being contributed but also in terms of the desirable multilateralization of the process of consultation with recipients as to their domestic development policies and advise on the proper use of aid funds.

The same insistence on working in concert with other aid giving countries of course applies to U.S. policy towards the older development-oriented foreign aid cases in Asia. In India and Pakistan, for instance, which clearly represent the most important non-military counterweight to Communist expansion in Asia, both theory and experience argue for the possibilities of effective efforts if carried out under a multilateral umbrella. It matters relatively little whether this umbrella takes the form of a tightly knit consortium, complete with aid pledges--or the more informal setting of a consultative group. The heart of the matter lies in the creation of a relatively political and technically-oriented setting in which information can be exchanged, advice given, and a sensible division of labor agreed upon. The U.S. would certainly support any further strengthening of aid cordination and multi-lateralization devices.

A second major pillar of U.S. foreign assistance policy of considerable relevance to Asia is the emphasis on regional approaches to development where such are viable or can be expected to eventually become viable. The U.S. believes--and past experience has tended to bear it out--that the overwhelming strength of the forces currently at play in the less-developed world are centripetal in nature, i.e., tending to pull countries apart, along tribal, ethnic or linguistic lines. While it is difficult--and probably unwise--to be doctrinaire on this issue, there can be little doubt that the utter disregard for economies of scale at home and for bargaining power abroad has led a number of countries down the slippery--and costly--road to attempted self-sufficiency and autarky. While some of these forces are indeed deeply imbedded in history and culture, the U.S. feels that its aid efforts, though clearly of marginal weight in the balance, ought to at least be registered on the side of those forces making for cohesion and the consolidation of otherwise splintered members of a regional group. Not only is there a real question as to the simple viability of some of the smaller nation-states which have put in an appearance of late, e.g., in Africa, but also--and more relevant to Asia--the pace of overall progress in the less developed world can be substantially affected by the presence or absence of regional approaches to development.

The U.S. view of regionalism is not a doctrinaire, but a pragmatic one. For some purposes, e.g., river development, one regional grouping may make sense; for another, e.g., coordination of policy towards tourism, quite another. Pragmatic regionalism really has some of the aspects of a floating dice game, with changing partners for different purposes. Moreover, for any particular grouping, we are fully conscious of the wide gamut of choices, from occasional multinational projects on one extreme, to complete policy harmonization within a common market context, on the other. Moreover, any but the most starry-eyed assessment of the present objective economic situation in Asia is bound to impress with the need for caution and the chance for little more than slow progress in the years immediately ahead. Nevertheless, this journey too has its initial small steps which must be registered when and if the opportunity presents itself.

Most basic of all is our fundamental conviction that virtually any aspect of what is loosely called regionalism must be conceived within the region itself before it has any real chance of survival. While, by now, it is a well-tried and tested truism to say that the entire foreign assistance effort, to be successful, must be understood--and fully supported by--the recipients, the force of the argument runs with particular strength when more than the individual recipient nation state is involved. Any regional idea will ultimately be still-born unless it has deep roots in the region--and no regional plan or multi-national project shelf worked out on the outside will suffice even if the money is accepted and papers are signed. Admittedly, the need for results and achievements--partly self-imposed and partly linked to pressure from donor country legislatures--may at times tend to make us forget this basic fact of life, but it has increasingly become the cornerstone of our aid policy in Asia.

To come down to specifics, the U.S. would surely like nothing better than some--if tentative--motion towards a regional approach to development in the Indian Sub-continent. There could hardly be a more effective way for the truly scant resources of that area to be applied to the monumental task at hand. Experts agree that there exist real possibilities--in the joint development of the Brahmaputra, in natural gas and fertilizer, and in jute, to start at the most modest (multinational project) level, as well as in the more ambitious areas of putting parts of the Partition-torn economy back together again via joint transport and, eventually, common market arrangements. But the time clearly has not yet come when our aid program in the Sub-continent can be based on any such immediate prospects. Meanwhile our strategy remains one of continuing to assist with the most effective national-oriented development programs which can be devised--while ready to respond to any sign of a further thaw in sub-continental political and economic relations.

With respect to Southeast Asia, the same caveat must of course be observed. Nevertheless, it should be clear that in this Region, with its relatively numerous small export-oriented economies, the potential payoff from regional rather than strictly national efforts may be especially large. Therefore, any reasonable efforts to explore the possibilities deserve careful consideration. While some rather modest steps have already been taken, we intend to briefly explore a number of possible limited further actions which remain open.

As we have already noted, regionalism is viable only if it builds on some generally accepted aspect of economic (or political) interdependence. Usually the mildest version of interdependence comes from the recognition that some projects --by virtue either of the physical character of the undertaking or the required economies of scale unattainable within any one country's boundaries--must be viewed cooperatively if they are to be undertaken at all. The work of the Mekong Committee in the context of which 23 donor countries have committed nearly 70 million dollars to river-basin-related development is the prime South-East Asian example of this most elementary "natural" form of regionalism. Somewhat, but only slightly more, ambitious are the Malaysian proposals for a regional transportation and communications network which would provide essential overheads as a consequence of joint planning, in place of disparate--and possibly competitive--actions by the individual countries concerned. The very same fundamental principle applies to such "natural" regional activities as indigenous disease and pest control, for example.

A third and substantially more meaningful step would be agreement among the countries concerned on some ideal division of labor in the field of applied research and human resources development. The Southeast Asian Ministers of Education (SEAMES) have met several times in an effort to decide where various regional centers of educational excellence might best be located. Such centers will probably have a much better chance if they start life as national institutions and become regional, in fact, over time by virtue of their instrinsic high quality rather than because someone has put up a sign designating them as such. This caveat would seem to apply inter alia to the proposed institutes of technology, of higher education, of science and mathematics, of educational radio and TV, all of which have been discussed in the recent past. With respect to research on problems common to the region, e.g., fisheries, tropical medicine, etc., the highly successful example of the markedly successful International Rice Research Institute should be kept in mind.

Hopeful beginnings have thus been made in the exploration of priority projects tinged with substantial externalities. These are admittedly positive steps, but we must be careful not to overstate their significance in terms of the real concessions made from positions of traditional nationalism and autarky. Perhaps the best way to gain a judgment on this matter is to ask a prior, more substantive question, i.e., what further steps in exploring the potential interdependencies currently existing in, say, Southeast Asia, are, in fact, one, desirable, two, feasible, and finally, how can U.S. foreign assistance be of help.

Measures oriented to taking advantage of existing interdependencies, potential or otherwise, and to build a more rational division of labor in the Region, quickly lead us to the consideration of some form or other of economic integration, with intra-regional trade promotion as a key objective. At present, as table IV indicates, the less developed countries of Southeast Asia trade mainly with the developed countries outside the Region. Intra-regional trade amounts to only 16-17 percent of the total and is concentrated on food and other primary products. Under these circumstances there seems to be at least an _a priori_ case for attempting to enlist intra-regional trade as a supplemental engine of growth. The growing importance of this engine is being increasingly recognized. Intra-ADC trade has been growing at 6.5% annually during 1960-1965, compared to 2.8% in 1955-60. Unctad II, in contrast to Unctad I, expects to pay much more attention to the potential for further substantial growth in such intra-LDC exports. There can be little doubt--though we can only assert it here--that the possibilities of expanding exports--in non-traditional commodities and to non-traditional partners--is the less developed world's best hope.

Steps toward integration, of course, come in many packages, from payments unions, to free trade areas, to common markets and complete harmonization. Few observers who have watched European progress and Latin American discussions on this subject in recent years are very bullish about what is achievable in the short-term in Southeast Asia. Hard-headed skeptics are quick to point out that even if current problems are laid aside nationalism and autarky continue to run deep. Moreover, technical obstacles are frequently cited, including the lack of complementarity among the economies of the Region and the tendency of some to run continuous deficits within the Region.[1] It certainly can be said with some confidence that the area is not exactly ripe for any of the more far-reaching possibilities cited; in fact, recent ECAFE experience with even modest attempts to achieve some harmonization of investment plans indicates that neither the basic political trust nor the realization that major economic gains are there for the asking exist at this time. Nevertheless, it seems clear to us that while there can be arguments about the precise form and time-table of the movement towards regional integration, its ultimate inevitability should be recognized. Some room of regional grouping seems to make sense as an interim approach for the LDC's in the area while the developed countries continue to discuss more global solutions. Some general observations on the pros and cons of various possibilities are therefore in order.

First of all, the present military conflict, there seems to exist no pervasive reason why a modest goal such as an Asian Payments Union must be ruled out, even for the near-term future. The economies of South Asia are much more complementary than the long dreary history of ECAFE sessions gives them credit for. There are the rice surplus and the rice deficit countries, there are the small trade-oriented economies and the larger domestically oriented economies. But, and much more important, the potential for future intra-Southeast Asian trade under the assumption of respectable growth rates in each of the individual countries of the region is very considerable. One can certainly already see a possible division of labor, with the Philippines and Malaysia concentrating

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[1]ECAFE expert groups have consistently pointed to this obstacle as if it were a proven long term structural problem.

on the production of consumer goods, Thailand on rice, and Singapore on light capital goods. Given the labor surplus characteristics of most of the Region, trade in labor intensive wood and wood products, leather goods, textiles, both within the Region and,.especially after some time, with major trading partners outside, has considerable potential. There certainly exist as yet unexplored possibilities for intra-regional manufactured exports, and import substitution on a regional basis is certain to be less costly. While I cannot claim to be a specialist in the comparative cost and production structure of the South-East Asian countries, I have no doubt whatsoever that a number of industries could now be identified in each country as candidates for economic expansion with integration. Such identification is, however, perhaps best left to market determination rather than to the cost estimates and log-rolling efforts of experts and officialdom. Present intra-regional trade levels are highest for Thailand, Taiwan and Malaysia (see table IV), i.e., among the fastest growing of the major countries in the Region.[1] Should Indonesia develop along the lines that we are now entitled to hope for she could easily obtain the more flexible production structure required for productive participation in any such regional grouping. The same is true for the Philippines, although here the gap between what is possible and what is likely to happen--under any reasonable set of assumptions--continues to be larger.

Assuming that the above is a fairly accurate description of reality what first step is it feasible to take and who should be included in any such grouping? On the first question, the answer is relatively easy. It normally does not pay to run before one can walk. A regional clearing house arrangement or payments union might well have to precede any further move towards a free trade or common market area. It would have the clear advantage of permitting an increase in the intra-regional trade currently carried on in inconvertible currencies, even when all other internal and external restrictions are unaffected. Secondly, and perhaps of greatest immediate benefit, it would save scarce foreign exchange for all its members by reducing the need to carry substantial idle key-currency working balances.

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[1]Korea's peculiar geography and history have, until very recently, tied her more closely to Japan, which is outside of our "Intra-S.E. Asia".

TABLE IV

S.E. Asian Trade Patterns, 1953-1966
(in millions of dollars)

	Imports	% of Total	Exports	% of Total	Trade Balance
Burma:					
Intra-S.E. Asia*	458.2	15.3	1,439.8	45.4	981.6
Pacific Countries**	904.7	30.2	338.8	10.7	- 565.9
Rest of World	1,636.4	54.5	1,392.7	43.9	- 243.7
Total	2,999.3		3,171.3		172.0
Cambodia:					
Intra-S.E. Asia	99.5	10.0	48.0	6.2	- 51.5
Pacific Countries	239.0	24.1	118.9	15.4	- 120.1
Rest of World	653.6	65.8	605.0	78.4	- 48.6
Total	992.1		771.9		- 220.2
Hong Kong					
Intra-S.E. Asia	2,099.0	15.3	2,482.5	26.5	383.5
Pacific Countries	4,059.1	29.1	2,582.3	27.5	- 1,476.8
Rest of World	7,549.3	55.1	4,293.6	45.8	- 3,255.7
Total	13,707.4		9,358.4		- 4,349.0
Indonesia:					
Intra-S.E. Asia	967.2	11.6	624.8	6.4	- 342.4
Pacific Countries	3,131.1	37.5	3,507.4	35.7	376.3
Rest of World	4,231.9	50.8	5,690.7	57.9	1,458.8
Total	8,330.2		9,822.9		1,492.7
Korea:					
Intra-S.E. Asia	246.1	4.5	73.7	7.9	- 172.4
Pacific Countries	4,334.7	79.2	632.3	68.0	- 3,702.4
Rest of World	890.5	16.3	223.7	24.1	- 666.8
Total	5,471.3		929.7		- 4,541.6
Laos:					
Intra-S.E. Asia	105.8	32.5	36.7	85.3	- 69.1
Pacific Countries	89.3	27.4	.6	1.4	- 88.7
Rest of World	130.8	40.1		13.3	- 125.1

* Including all of Eastern ECAFE and excluding Japan.
** Japan, Canada, Australia, New Zealand and the U.S.

Table IV (continued)

	Imports	% of Total	Exports	% of Total	Trade Balance
Malaysia:					
Intra-S.E. Asia	7,186.6	36.6	2,599.3	13.8	- 4,587.3
Pacific Countries	3,643.2	18.5	6,120.2	32.6	2,477.0
Rest of World	8,832.4	44.9	10,050.9	53.5	1,218.5
Total	19,662.2		18,770.4		- 891.8
Philippines:					
Intra-S.E. Asia	628.4	7.0	167.8	2.2	- 460.6
Pacific Countries	6,291.4	70.4	5,783.6	75.0	- 507.8
Rest of World	2,021.3	22.6	1,759.6	22.8	- 261.7
Total	8,941.1		7,711.0		- 1,230.1
Taiwan:					
Intra-S.E. Asia	122.5	3.3	517.8	19.2	395.3
Pacific Countries	2,819.3	76.1	1,400.6	51.9	- 1,418.7
Rest of World	764.6	20.6	778.8	28.9	14.2
Total	3,706.4		2,697.2		- 1,009.2
Thailand:					
Intra-S.E. Asia	559.3	7.9	853.2	14.1	293.9
Pacific Country	3,481.0	49.0	1,847.1	30.5	- 1,633.9
Rest of World	3,066.9	43.2	3,360.9	55.4	294.0
Total	7,107.2		6,061.2		- 1,046.0
Vietnam:					
Intra-S.E. Asia	493.2	15.8	78.5	11.2	- 414.7
Pacific Countries	1,506.8	48.3	90.4	12.9	- 1,416.4
Rest of World	1,114.7	35.7	532.0	75.9	- 582.7
Total	3,114.7		700.9		- 2,413.8
Total S.E. Asia:					
Intra-S.E. Asia	12,965.8	17.4	8,922.1	14.9	- 4,043.7
Pacific Countries	30,499.6	41.1	22,422.2	37.3	- 8,077.4
Rest of World	30,892.4	41.5	28,693.6	47.8	- 2,198.8
Total	74,357.8		60,037.9		-14,319.9

Source: U.N. Directions of International Trade, 1951-May, 1964. Published Jointly by U.N., I.M.F. and IBRD. June 1964 - Direction of Trade published jointly by I.M.F. and IBRD.

Finally, it would, as European and Central American experiences has demonstrated, have substantial dynamic effects on the participating members' willingness to move towards more ambitious methods of exploiting the interdependencies within the Region.

The question of the inclusiveness or exclusiveness of such a grouping represents, of course, a more delicate issue. As Professor Triffin in a recent related ECAFE paper has pointed out, it may well make sense to think in terms of various natural intra-regional subgroups appearing possibly sequentially even when only payments unions objectives are contemplated.[1] Whether or not the five major Pacific countries (including the three developed ECAFE countries) should be included is a more difficult matter. Reserve gains by some of the Southeast Asian countries during the last 10 years, for example, far exceed losses in others and give one some comfort that there could be a sufficiently strong overall reserve position within the Region, e.g., with Malaysia, Thailand and Taiwan as creditors, to "go it alone". On the other hand, there are clearly substantial advantages if Japan, possibly also Australia and New Zealand, (but much less likely the U.S. and Canada) were to join.

If we were at the same time to look ahead to a free trade or common market configuration, ideally co-terminous with the payments arrangement, the question of inclusion or exclusion of one or more of the major Pacific powers becomes more difficult. From the logical point of view it may seem to make sense to have Japan, likely to be in a substantial creditor position, join such a group and provide the transportation, heavy capital goods and technical skills required by the industrialization effort in the Region. This might be less attractive,--at least in the near term future--however, for some of the other major Pacific powers which provide substantial amounts of foreign assistance to the area and whose balance of payments might be adversely affected. From the point of view of maximizing the total flow of foreign capital to the Region and ensuring its most efficient allocation, along with that of the domestic resources which can be generated, there is no pressing need for any of the Pacific powers to be on the inside. If Japan were to re-

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[1] Robert Triffin, "Payments Arrangements within the ECAFE Region," August, 1967. Paper presented to the ECAFE Meeting of experts.

main outside, this might be more acceptable not only to the other Pacific powers but also to the less developed countries in the Region; Japan would still be in a position to provide much of the capital goods and know-how and stand to be a prime beneficiary of the growth of demand accompanying sustained development. For even if Japan were to enter as a partner within a common market framework, she would undoubtedly be asked to provide special concessions to her less developed partners, since otherwise both the export promotion and import substitution objectives in most of these countries, taken as a whole, would be jeopardized. The experience in Europe of the less developed, Southern group of countries is certainly instructive here.

The question that must still be faced is the manner in which foreign assistance can influence the situation and ease the burden of any decisions that are made. Clearly, if there is one thing we have learned in the course of the last 20 years, it is that foreign aid as a lever to effect desirable changes either within a country or in relations among countries is bound to be ineffective or even counterproductive unless two conditions are met. First, there is an honest and fundamental agreement among the experts and policy makers on both sides as to the inherent desirability of the step or steps to be taken; and second, that the foreign assistance funds made available tend to cushion any transitional pains, psychological or real, likely to be incurred in the course of adopting the particular policy changes. With four-fifths of the saving and an even higher percentage of the human capital provided by the less developed countries themselves, emphasis on the catalytic potential of the marginal foreign aid resources, rather than on the real resources transfer itself should lead one to an examination of how such funds can be used to assist the centrifugal forces in the area. For example, it might well be possible to establish an integration fund to ease both the temporary balance of payments pain (real or imagined) of countries joining in a common market, as well as individual industry adjustment pains. Such a scheme might be administered by ECAFE not normally an operating institution, or by the Asian Development Bank, which it is hoped, will, within a relatively short period of time, be in a position to do much more than act like a conventional bank making project loans to member countries. In fact, if the A.D.B. should be successful in organizing consultative groups for the major countries in the Region, getting involved in their overall development policies as well as in tackling such key sectoral problems as agricultural stagnation, it would become a natural for any related broader regional initiative to be headquartered there. The U.S. position on this general subject is quite clear. As recently as September 27, in sending the Executive Branch's request for A.D.B. special funds to the Congress, the President reiterated his desire to see "our foreign assistance handled through multilateral arrangements". The firmest basis for successful interregional as well as extraregional trade promotion is surely vigorous growth in each of the individual countries. If the Bank were to be in a position to have the various threads of aid and trade relations run together, through it, it would be in the enviable position of short-cutting by more than 15 years the learning processes of the World Bank in its own global arena.

Future U.S. aid policy in Asia will continue to be aimed at moving as quickly as circumstances permit from security/ stability to developmental situations, and moving developmental situations, past, present and future, as quickly as possible to the point of graduation or self-sustaining growth. The means of achieving the former lie largely outside the realm of foreign assistance policy; the means of achieving the latter, we believe, lie largely in working towards a strategy which ensures the enlistment of medium and small scale production units and their creative energies on an entirely different scale, within each aided country, and one which highlights the multilaterization of aid and trade as important facilitators of that process, as among the aided countries in the region.

Chapter 12

JAPAN'S ROLE IN ASIAN ECONOMIC DEVELOPMENT

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I Introduction

After the war, the Japanese economy has attained rapid growth, and its international position has been greatly enhanced. Consequently Japan now assumes greater responsibility for assisting the economic development of less-developed countries. In 1966, Japan's gross national product totalled nearly 100 billion U.S. dollars; and today the size of Japan's economy is as large as that of the economy of Britain, West Germany or France. Japan's GNP almost equals in size the aggregate GNP of all the less-developed countries in Asia (excluding mainland China) with a total population of about 900 million. While in other parts of the world, North America is strengthening its ties with Latin America and Western Europe with Africa, Japan's role in the economic development of Asia now assumes greater importance.

Since Japan ranks among the major countries importing primary products from developing countries, Japan's policy on trade, import trade in particular, as well as on foreign aid has important bearings upon the future of other Asian countries. As the Japanese economy has acquired greater importance for other Asian countries, business fluctuations in Japan, for instance, give direct impact upon their economies through the fluctuations in their exports to Japan. If the Japanese economy continues its high growth tempo, it will create a better environment for the export trade and the economic development of these countries. Therefore, the stable and steady growth of the Japanese economy is required not only for Japan's domestic well being but also for the economic improvement of other countries in Asia. As the case stands, in formulating various policies, Japan should give adequate consideration to their possible influences on other nations, particularly on the economies of developing countries in Asia.

II Inter-dependency between the developing countries in Asia and Japan

Those developing nations in Asia discussed here in this paper are practically the same as the ECAFE regional member nations which exclude China (mainland), North Korea and North Viet Nam. According to the United Nations "Economy Survey of Asia and the Far East, 1966", the ratio of export to Japan from the developing ECAFE nations to their total export rose from 9.6 percent in 1960 to 13.4 percent in 1965. Japan's share in the export from these countries exceeded that of Great Britain which constituted 10.4 percent in 1965, and came right after that of the United States which accounted for 17.4 percent in 1965. While the total export from these countries gained only by 23 percent during the five year period from 1960 to 1965, their export to Japan rose by 83 percent.

The share of the developing countries in Asia in Japan's import and export trade has been declining after World War II. Their share in Japan's export fell from 40 percent in 1951 to 26 percent in 1965, and in Japan's import also declined from 26 percent in 1951 to 17 percent in 1965. Over the past few years, however, these shares seem to have ceased to show much decrease and is now stabilized at about 17 and 26 percent respectively.

As mentioned already, Japan's GNP almost equals the aggregate GNP of all the developing countries in Asia and is annually growing by about 10 percent, Japan is now an important export market for the products of these Asian countries.

In the first place, Japan must continue to import increasing quantities of raw materials, fuels and foodstuffs to sustain its expanding economy. In 1965, Japan imported two-thirds of its total consumption of energy--mostly in the form of petroleum. This ratio is expected to rise to 80 percent in 1975 and further to 90 percent in 1985. Even if Japan is to generate in 1985, 30 million kilowatts of nuclear power corresponding to one-third of its total power generation capacity and assuming nuclear power as domestic energy, the ratio of the imports of energy resources will change only from 90 to 80 percent. Japan will continue to import most of the iron ore and non-ferrous metal ores it requires. Its import of raw cotton and raw wool may somewhat decline, but Japan must continue to import the total quantities of these textile raw materials it consumes. In 1966, lumber was the second largest import of Japan, coming only after petroleum; and its import will further rise in the years to come. Imports of animal feeds such as maize and kaoliang are sharply increasing. In 1966, Japan's feed imports amounted to 5.7 million tons; and in the near future they will exceed the 10 million ton mark. Imports of oil seeds, sugar, bananas and marine products will also expand. If other nations in Asia can effectively produce the above-mentioned products, these countries will be able to greatly expand their exports to Japan.

In the second place, the Japanese economy is now encountering the problems of intensifying labour shortage and high wages, and its favourable position in labour-intensive industries has been gradually weakened and so has been its competitive power in international trade in such areas. In the coming years, increasing quantities of manufactured and semi-manufactured products will be imported from the developing countries into Japan. Moreover, the share of imports of Japanese products, particularly of labour-intensive products, into the United States market has been substantially declining. During the period from 1955 to 1965, Japan's share in the imports of cotton textiles into the United States fell from 55 to 29 percent, that of clothing from 40 to 25 percent, that of plywood from 28 to 26 percent, that of toys from 72 to 53 percent and that of artificial flowers from 87 to 9 percent. On the other hand, Japan's imports of labour-intensive goods are on the steady increase. Japan's imports of such products gained by 6.2 percent annually during 1956-60, but they rose by 33.5 percent annually during 1961-65. Such a sharp increase should be primarily attributable to a sharp gain in the exports of light industrial products to Japan from other countries in Asia such as Hong Kong, Taiwan and South Korea. If the developing countries in Asia hope to expand their exports of labour-intensive products, Japan will offer an excellent market for their products.

While Japan does and will offer a good and growing market for both primary and light industrial products of the developing countries in Asia, these countries are developing into important markets for the products of Japan's more sophisticated industrial products. During 1950-1965 the GNP of the developing countries in Asia attained an average annual growth of 4.0 percent. Keeping pace with the progress in the modernization of agriculture and the development of manufacturing industries in these countries, their economic growth is expected to be accelerated in the future. According to the economic development plans for the latter half of the 1960s, the ECAFE member developing nations aim at attaining of about 6.2 percent economic growth. Our projection shows that these countries will shortly attain the goal of 5.0 percent annual economic growth set forth for the Development Decade 1960s by the United Nations, as shown in Table 4.

Consequently, the economic development of these countries which will be achieved through their trade and economic and technical cooperation offered by advanced nations now presents a highly important problem to Japan which fact points out to both parties the significance of inter-dependence.

In order to analyze the inter-dependence between the developed nations--Japan, Australia and New Zealand--and the developing countries in the ECAFE region, we have prepared an inter-country relations table (Table 1.) This Table shows the type of inter-dependence through trade between the three advanced nations and the 18 developing countries in the region. This Table will enable us to make a quantitative analysis of the inter-dependence through trade between Japan and other Asian nations. Tables 2 and 3 show an outlook for the ECAFE region economy in 1970. While Table 2 shows an outlook based upon the past performance of the economy, Table 3 presents an outlook based upon the goals as set forth by each of the ECAFE member nations. Both of these tables were prepared in accordance with economic growth models for the countries enumerated in the Appendix.

Per-capita GNP of Japan in 1965 amounted to nearly US$800 (in 1960 prices) as compared with an average of nearly US$100 in the developing countries in Asia. The difference in the per capita GNP between Japan and the developing countries in Asia is likely to further widen in the years to come, and the demand for Japan's increased aid and imports by the developing countries will become stronger in the future. The North-South problem in Asia will be the most serious among the similar problems in the world; and Japan's policy toward Asia, particularly those on trade and aid, will assume an important role in the economic development of these countries.

III Economic development of Asia and Japan's policy

In order to assist in the economic development of developing countries and also to expand foreign trade, Japan must expand its imports, particularly from its neighbouring countries in Asia. Since Japan's exports to these countries exceed its imports from these countries in most cases, Japan must do its utmost to increase such imports. However, these developing nations are not always able to meet Japan's requirements (as to quality, prices, quantity, etc.) this may partly be attributable to Japan's inadequate trade and aid policy, but the development plans and policies followed by these newly-independent nations in Asia are thought to be partly responsible.

After the war, many newly-independent countries in Asia have not followed, in reaction to colonial domination, a policy of economic development through exports of primary and light industrial products but have concentrated their efforts on the production of import substitutes intended for their domestic markets depending upon heavily on financial aid from developed countries. As a result, these nations have been unable to meet increased import requirements for economic development with an increase in their export earnings; and their balance of payments have been constantly in deficit and their borrowings from abroad have accumulated.

From its own experience in the economic development, Japan has been advising other Asian nations that at the early stage of economic development the improvement of agriculture and the development of light industries for producing exportable commodities should receive high priorities. However, this advice has often aroused suspicion on the part of the developing nations in Asia that Japan wants these nations to remain agricultural and light industrial nations. What Japan really means is that each developing nation must first improve agriculture in order to promote its industrialization effectively and that it must develop light industries capable of gaining export earnings to enable it to earn foreign exchange required for establishing its heavy industries. If the developing nations follow such a policy, it will be able to derive the benefit not only of the so-called "economy of scale" by exploiting the large markets in the advanced industrial nations but also of international division of labour based upon comparative advantage.

The history of Japan's economic development in the past and the recent economic improvement of China (Taiwan) offers interesting examples in this respect.

In the latter half of the 1960's, however, many of the developing countries in Asia came to re-examine their development policies and to follow a new policy placing emphasis on the improvement of agriculture and the export of primary products and finished or semi-finished products. It is expected that a new pattern of international division of labour will thus be formed in the years to come to common benefit of Japan and the developing countries in Asia.

As is generally known, Japan imports most of the industrial raw materials, fuels and foodstuffs it needs from abroad and exports manufactured goods. Therefore, Japan has no reason to oppose, in principle, to the elimination of various trade barriers against exports of primary products from developing countries as well as to the expansion in the imports of such commodities through trade agreements. On the contrary, Japan will have to recognize the significance of interdependence between itself and the developing countries because it must secure stable supply sources of ever-increasing industrial raw materials, fuels and foodstuffs as well as the export markets for its industrial products. If the granting of preferential tariffs for manufactures and semi-manufactures exported from the developing countries could help speed up the industrialization of these countries, such preferential tariffs would form a potential factor producing mutual benefits to Japan and the developing countries not only of "vertical division of labour" but also of "horizontal division of labour" in the long run. In other words, the industrialization of the developing countries would not mean a loss of Japan's export markets but it would mean an expansion in its exports.

Of course, the above-mentioned statement does not mean that the elimination of trade barriers to the primary products and the offer of preferential tariff rates to the manufactures and semi-manufactures exported from the developed countries cause no damage to certain commodities. However, Japan already has made a great progress in trade liberalization. Japan's demand for primary products is steadily increasing, and the abolishment of trade barriers to the imports of primary products is not thought to inflict much damage to the economy of Japan as a whole. Imports of industrial raw materials have been almost completely liberalized, and such commodities are either exempted from duties or subject to low duties. However, there are quite a few items of foodstuffs such as rice, wheat and edible oils which are not yet liberalized. Customs tariff rates on banana, black tea and a few other items are quite high. In order to stop general price hike and also to meet import liberalization and the elimination of trade barriers to the imports from the developing countries, efforts are now being made to free Japanese agriculture from excessive protectionism and to modernize it. To stabilize commodity prices in Japan, it is urgent to strengthen the international competitive power of agriculture through structural reform and reorganization.

The preferential tariffs to the exports of manufactures and semi-manufactures from the developing countries would affect the Japanese economy in a different way from the elimination of trade barriers to the imports of primary products from such countries. Increased imports of primary products would constitute competition simply with Japanese producers in the domestic market. But preferential tariffs on the manufactured and semi-manufactured products would intensify competition not only in Japan's domestic market but also in overseas markets. In case all developed nations including Japan are to offer preferential tariffs to the products of developing countries, Japanese industries producing the same or similar commodities would inevitably be affected. Some of such Japanese industries might weaken their position in overseas markets under the pressure of expanding exports from the developing countries. However, taking such a possible developments into account, Japan should form a judgment from a broader and long-range international policy viewpoints.

In order to develop and industrialize the developing countries, their overseas markets must be expanded. It may be desirable for Japan, in the long run, to allow developing countries to take over some of its overseas markets for commodities which can be produced under more favourable conditions in the developing countries. Such a shift in international trade would insure the more effective utilization of world resources and labour. To improve the existing economic structure of the developing countries and to accelerate their economic development, it is imperative that the advanced nations should also change their trade and industrial structure to better contribute to the improvement of the international trade structure.

We have no reason to believe that such a change or adjustment of industrial structure of the developed nations can be carried out smoothly and without any sacrifice. It naturally follows that the government of each of the advanced nations should not oppose to such industrial adjustment but should tackle the problem with a forward-looking attitude and strive to minimize the sacrifices demanded of certain producers and to increase the benefits of the nation as a whole to the utmost extent. Such efforts would contribute in the long run to the well being of the entire world inhabitants including those in the developing countries.

The major obstacles are oppositions raised by the groups directly affected by such a policy and this will create political pressure on the government. In order to avoid political difficulties in the developed countries measures should be worked out to minimize such obstacles.

IV Economic development of Asia and Japan's aid policy

In discussing the role of Japan's aid in the economic development of Asia, it is thought appropriate to examine Japan's basic policy on aid to these countries. Japan's postwar bilateral aid to developing countries in Asia was started with its economic cooperation under the reparations programmes, the first case being the reparations agreement with Burma concluded in 1954. In the same year, Japan joined the Colombo Plan and started to offer technical cooperation to South and Southeast Asian countries. Since Japan became a member of the United Nations in 1956, it has been participating in multilateral aid efforts exerted by various international organizations. In 1960 Japan became a member nation of DAG (Development Assistance Group), which later became DAC of OECD, and the position of Japan as an aiding country was further consolidated.

As already mentioned, Japan's position as an aid-offering nation has been steadily enhanced. However, soon after the war Japan was primarily concerned in its own economic recovery and development and did not and could not take a positive and consistent attitude toward aid to the developing countries. However, as Japan's economic power has steadily increased, Japan could no longer maintain such a passive attitude. During the latter half of the 1960's, Japan took a new turn in its aid policy. Japan possitively participated in the Asia Development Bank and took a leading part in calling the Ministerial Conference on the Development of Southeast Asia and the Southeast Asia Agriculture Development Conference. These actions indicate that there has been a change to a more positive attitude toward aid programmes.

While Japan's share in the burden of economic aid is still comparatively small and the conditions of Japan's aid offers are not so liberal, Japan will have to follow a positive aid policy of its own in view of its increased international responsibilities. Since there are but a limited number of nations capable of offering aids to developing countries in Asia, efforts should be made to carry out aid programmes most effectively. Since the economic aids now being offered are not charity undertakings, Japan's national interest should naturally be taken into account in furnishing aid. However, if Japan's aid is effective and efficient in accelerating economic development of other Asian countries, it will advance the mutual interests of both the aid-giving and the aid-receiving countries.

When we discuss the effective execution of aid programmes, we sometimes point out the fact that aids given to the developing countries by the advanced nations have not produced desired results. Often this fact is exaggerated, however. South Korea presents an interesting case, in this connection. When aids from the United States started to decline, the economy of South Korea miraculously started its high growth. Based upon this case, some economists contend that aids to developing countries do more harm than good. However, it cannot be said that the aids so far offered have been meaningless. Economic indicators show that aids furnished to Taiwan, Thailand and Pakistan have produced some encouraging results. It is unrealistic to expect that the same amount of aid will produce the same result in each aid-recipient country or that a large amount of aid will enable a developing country to accomplish "take-off". All the developing countries in Asia are not the same. They are widely different in the size of economy, stage of economic development, the endowment of natural resources, population, educational standards, political system, race and religion. It is only natural that aids given to these nations should be affected by these factors. It is necessary to note that the result of aid is vitally affected not only by the forms of aid but also by the conditions and systems in the aid-receiving countries.

OECD is now studying the forms of aid to be given by the advanced nations. Japan also will have to study its own aid policy to be followed in cooperation with other advanced nations. We believe that Japan's new aid efforts should be directed to the promotion of both bilateral aid and multilateral aids through international agencies.

To expedite the economic development of the developing countries, it is necessary to change and reorganize the existing inefficient economies into efficient ones on a world-wide basis; and for this purpose part of material and intellectual achievements so far reached by the advanced nations should be transferred to the developing countries. While economic aid from advanced nations undoubtedly promotes the development of developing countries, it is true that the economic development of the developing countries should be accomplished primarily by self-help. Therefore, aid efforts should be so directed as to accelerate the attainment of a self-sustaining economy. In order to carry out aid programmes most effectively, it may become necessary to create an machinery for mutual supervision to be jointly operated by the aid-giving and the aid-receiving nations. In this connection, Japan will have to establish standards for its economic aid and cooperation including priority, objectives and form of aid.

In 1966, aid given by Japan totalled $539 million, an increase of 17 percent over 1965. However, since the Japanese economy attained a high rate of growth during the year, the ratio of Japan's total aid to its national income fell from 0.71 in 1965 to 0.69 percent in 1966. Compared with the advanced countries in Europe and America where per-capita national income is high and the rate of economic growth is relatively slow, Japan's foreign aid is felt rather too heavy, as per-capita national income is low and growth rate of the economy is very high. This is the subject of further discussion by the OECD member nations.

It should be noted, however, that if an aid programme is most effectively carried out, the aid equivalent to one percent of national income will not mean a complete "leakage" or loss to the aid-giving country but will mean a "real" reduction in its aid burden. An effective expansion in Japan's foreign aid to the developing countries would increase its exports of industrial products and would push up the purchasing power of the people of the aid-receiving countries. Thus in the long run, a reduction in the government's domestic expenditures caused by an increased outflow of capital in the form of aid would be partly offset by an increase in export earnings. On the other hand, if aid from Japan should be wasted away and should not lead to an expansion of foreign trade, then the "aid" would mean a "real" loss to Japan.

Tables 5 and 6 show possible effects of Japan's financial aid to developing countries equivalent to one percent of its national income upon its economy based upon the "Dynamic Multi-Sector Model for the Japanese Economy" attached hereto. Case No.1 presents a picture of a case where Japan's aid equivalent to one percent of its national income is effectively utilized and increases Japan's export trade, while Case No.2 shows what would happen if Japan's aid is simply wasted away and causes no increase in foreign trade. In the Case No.1 the annual growth rate of the Japanese economy will stand at 8.7 percent during 1963-70, while in Case No.2 it will be 7.5 percent. In Case No.2, the aid would not simply increase Japan's financial burden but also would adversely affect the aid-receiving nations because of a possible decline in Japan's imports from these countries. The figures on these two tables explain that if Japan's aid is not increased within the limit of an amount acceptable to the Japanese economy and if the aid-receiving nations do not most effectively carry out their development programmes, the aid will produce no benefit either to the aided nations or to Japan. If Japan's aid is utilized effectively to develop the manufacturing industry to be established on the foundation of improved agriculture, the economic development of the aided countries will be expedited, their economic structure improved and the levels of their economic activities raised. However, such development will inevitably increase the imports into the aid-receiving countries. Therefore, if their exports do not increase, their balance of payments will show increased deficit and their "needs for aid" will increase. If Japan simply offers aid and does not expand its imports from the developing countries, the economies of the aided nations would become all the more dependent upon aid from the developed nations. Such being the case, Japan should increase not only its aid to the developing countries but also its imports from them.

The increased production and imports of primary products from the developing countries into Japan will benefit both Japan and these developing countries. In order to attain self-sustaining economic growth of the developing countries by their self-help efforts, these countries should not only modernize agriculture but also should industrialize themselves. The preferential tariffs offered to the imports of manufactured and semi-manufactured products should be regarded as part of aid efforts.

In order to be prepared for its increased aid efforts and the larger imports from developing countries as well as granting of preferential tariff rates to the imports from the developing countries, Japan will have to adjust its industrial structure. Subsidies for the modernization of agriculture and for the rationalization of smaller enterprises or their shifting to other types of business will have to be considered as part of Japan's overall aid programme. By observing the present stage of Japan's economic development from an international viewpoint, Japan should allow the developing nations to take over some of its overseas markets wherever possible and should strive to reallocate resources and labour for better use.

V Conclusion--Regional cooperation in Asia and the position of Japan.

The so-called "regional economic cooperation" can be divided into three stages; namely, cooperation, coordination and integration. EEC is an integration; but in Asia regional economic cooperation is still at the stage of cooperation or coordination. There are some sub-groups of neighbouring countries closely related each other politically and economically; and in such a case there may be some possibility of their developing into common markets or economic integrations. But in Asia as a whole and at the present it is still at the stage of strengthening step by step "cooperation" among countries.

Regional cooperation among the developing countries is necessary for two reasons. Firstly, even for the developing countries, it is necessary to secure the economies of scale in order to establish new industries economically. It is sometimes better for these nations to cooperate in the building of a common regional industry than to strive to establish import substituting industries individually. Secondly, from the viewpoint of the effective utilization of aid, it is not desirable that the aid-receiving nations compete with one another in securing aid and strive to develop industries producing same types of import substitutes. Thus regional cooperation among the developing countries would be a common concern of both the aiding and aided nations. For this reason it may be better for Japan to consider to orient its financial and technical aid efforts to assist and encourage to promote such regional co-operation.

Since the Japanese economy is much different from the economies of the developing countries in Asia, there seems to be only a remote possibility of Japan's participating in such an economic integration. Japan should rather extend cooperation multi-laterally or bi-laterally, make its accumulated knowledge and experience available to the developing countries and advise the formulation of feasible plans of cooperation.

If Japan is to participate in a regional cooperation group, there is the possibility of its joining a group of the developed countries in the Pacific area. If such a group is to be organized, Japan's policy on the development of Asia through trade and aid will have to be properly adjusted to the policies of other member nations. If a joint aid programme is to be mapped out by a group of the developed nations in the Pacific area for the developed nations, such a programme could be more effectively carried out than the one formulated by Japan alone. Making a comparison between the economies of the developed nations and those of the developing nations, one finds that the GNP of North America is 15 times the aggregate GNP of all the countries in Latin America, and the GNP of Western Europe as a whole is 10 times that of Africa. However, Japan's GNP only equals to the aggregate GNP of the nations in South and Southeast Asia. Thus aid to the developing countries in Asia is too gigantic a problem for Japan alone. It naturally follows that the joint and coordinated aid efforts by the five developed countries in the Pacific area is highly desirable in the light of the proportion of the aggregate economic output of the developed nations to that of the developing nations in the Asian-Pacific region.

Table 1: Inter-Country Relations of the Developing ECAFE Economy in 1969[(a)]

Imports from \ Exports to	1 Afghanistan	2 Brunei	3 Burma	4 Cambodia	5 Ceylon	6 Taiwan	7 Hong Kong	8 India	9 Indonesia	10 Iran	11 Korea	12 Laos	13 Malaysia	14 Singapore	15 Pakistan	16 Philippines	17 Thailand	18 Viet-Nam
1. Afghanistan	0	0	0	0	0	0	0	8.7	0	0	0	0	0	0	2.0	0	0	0
2. Brunei	0	0	0	0	0	0	0.3	0	0	0	0	0	68.9	1.2	0	0	0	0
3. Burma	0	0	0	0	29.3	0	9.0	25.1	33.3	0.2	0.6	0	10.9	11.2	25.2	0	0	0
4. Cambodia	0	0	0	0	0	0	13.2	0.1	0.5	0	0	0	0.2	9.2	0	0	0	1.6
5. Ceylon	0	0	2.0	0	0	0	2.0	12.0	0	1.1	0	0	0	0.2	5.6	0	0	0
6. China (Taiwan)	0	0	0	0	0	0	39.2	0.2	0	3.5	11.5	0	5.7	8.4	0.2	5.1	12.7	24.5
7. Hong Kong	0	1.0	6.5	12.0	4.0	14.4	0	2.3	27.2	2.6	5.4	1.9	126.3	0	3.3	8.8	25.6	3.5
8. India	15.4	0	12.2	3.3	37.0	0	12.4	0	10.3	13.3	0	0	23.4	29.8	22.1	1.0	5.9	3.0
9. Indonesia	0	0	0.1	0	0.5	0	7.0	3.7	0	0.5	0	0	53.8	93.0	0.5	17.9	10.3	5.9
10. Iran	0	0	1.0	0	11.4	1.8	7.4	96.5	0	0	0	0	5.6	16.6	31.5	0.3	6.5	0.6
11. Korea, Republic of	0	0	0	0	0	1.2	10.3	0	0	0	0	0	0	0.6	0	1.0	0.9	0.5
12. Laos	0	0	0	0	0	0	0.1	0	0	0	0	0	0	0	0	0	0.1	0
13. Malaysia	0	2.2	3.0	0.1	0	4.2	15.0	36.7	13.7	1.3	0.8	0	0	275.5	2.7	12.0	9.7	0.1
14. Singapore	0	8.3	3.9	3.3	5.7	3.3	35.9	16.0	86.8	2.2	6.4	0	449.8	0	5.4	5.6	36.3	2.9
15. Pakistan	2.0	0	8.6	0.6	5.1	0	18.6	35.6	0.2	2.5	0	0	1.9	1.0	0	1.6	0.2	0.6
16. Philippines	0	0	0.1	0	0	9.5	0.6	0.6	0	0	9.9	0	0.1	1.0	0.1	0	0.4	0.4
17. Thailand	0	0	1.1	0	5.4	8.0	68.1	3.9	36.2	0.4	0.8	8.7	83.9	48.6	0.4	8.5	0	2.4
18. Viet-Nam, Republic of	0	0	0	1.1	1.6	1.2	2.7	0	0	0	0	0	1.1	0.5	0	2.3	0	0
Sub-total Developing ECAFE region	17.4	11.5	38.5	20.4	100.0	43.6	250.0	229.4	208.3	27.6	35.4	10.6	831.6	496.8	99.0	64.1	108.6	45.0
19. Japan	9.1	0.1	71.5	17.8	31.5	141.4	295.9	147.3	130.8	40.5	178.3	2.3	52.8	129.9	62.4	134.2	190.2	61.4
20. Australia	0	0	7.1	0	17.4	11.1	69.8	51.7	8.9	5.6	6.7	0	39.4	44.7	13.6	13.7	9.5	3.1
21. New Zealand	0	0	0	0	0.6	0	2.0	4.0	0	0	0	0	4.6	0.6	0	1.5	0	0
ECAFE total	26.5	11.6	117.1	38.2	149.5	196.1	617.7	432.4	348.0	73.7	220.4	12.9	928.4	672.0	175.0	213.5	308.3	109.5
22. Others[(b)]	105.1	21.7	174.1	118.3	303.4	448.5	1,001.6	2,545.4	441.7	942.4	432.2	22.1	386.6	571.7	1,090.7	657.9	456.3	371.1
Total imports[(c)]	131.6	33.3	291.2	156.5	452.9	644.6	1,619.3	2,977.8	789.7	1,015.1	652.6	35.0	1,315.0	1,243.7	1,265.7	871.4	764.6	480.6

Notes: (a) Estimated figures based on past performances.
(b) Obtained as a residual.
(c) Includes services.

Table 1: Inter-Country Relations of the Developing ECAFE Economy in 1965[a] (continued)

At 1960 prices
(In million US dollars)

Imports from \ Exports to	Sub-total Developing ECAFE region	19 Japan	20 Australia	21 New Zealand	ECAFE total	22[b] Others	Total[c] exports	Total[c] Imports	Consumption expenditure: Private	Consumption expenditure: Government	Gross domestic capital formation	Gross domestic product
1. Afghanistan	10.7	0	0	0	10.7	63.4	74.1	131.6	1,134.1	88.1	115.6	1,280.3
2. Brunei	70.4	0	0.1	0	70.5	0.5	71.0	33.3	68.7	14.0	16.8	137.2
3. Burma	144.8	15.7	0	0	160.5	105.5	266.0	291.2	1,154.7	243.8	357.8	1,731.1
4. Cambodia	24.8	1.8	0	0	26.6	151.1	177.7	156.5	541.6	138.9	99.9	801.6
5. Ceylon	22.9	10.6	24.6	9.8	67.9	435.2	503.1	452.9	1,091.6	218.4	196.2	1,556.4
6. China (Taiwan)	111.0	94.1	1.5	0.4	207.0	254.1	461.1	644.6	1,755.7	461.4	471.2	2,504.8
7. Hong Kong	244.8	55.8	23.8	9.5	333.9	808.1	1,142.0	1,619.3	1,857.0	158.6	434.2	1,972.5
8. India	189.1	113.5	44.4	17.2	364.2	1,775.3	2,139.5	2,921.7	30,680.1	3,458.2	6,482.6	39,838.7
9. Indonesia	193.2	67.9	59.9	3.4	324.4	363.6	688.0	789.7	8,931.5	1,366.2	475.4	10,671.4
10. Iran	177.2	107.1	56.7	5.6	346.6	999.8	1,346.4	1,015.1	3,541.5	930.0	1,083.7	5,686.5
11. Korea, Republic of	14.5	28.6	0	0	43.1	319.4	362.5	652.6	4,249.9	579.1	681.5	5,220.4
12. Laos	0.2	0	0	0	0.2	0.7	0.9	35.0	186.8	20.2	40.3	213.2
13. Malaysia	367.0	234.7	41.7	4.0	647.4	747.5	1,395.3	1,315.0	1,736.2	510.6	532.5	2,859.6
14. Singapore	671.8	65.2	32.5	14.0	783.5	459.9	1,243.4	1,243.7	786.3	102.9	155.2	1,044.1
15. Pakistan	78.5	37.9	14.8	6.9	138.1	392.2	530.3	1,265.7	7,358.3	961.9	1,514.2	9,099.0
16. Philippines	26.0	201.8	2.0	0.2	230.0	599.9	829.9	871.4	3,029.1	359.9	608.6	3,956.1
17. Thailand	276.4	109.5	1.0	0	386.9	348.0	734.9	764.6	2,687.3	346.9	628.2	3,632.7
18. Viet Nam, Rep. of	15.5	3.8	0	0	19.3	221.0	240.3	480.6	2,336.1	675.4	325.8	3,097.0
Sub-total Developing ECAFE region	2,638.8	1,148.0	303.0	71.0	4,160.8	8,045.6	12,206.4	14,684.5	73,126.5	10,434.5	14,219.7	95,302.6
19. Japan	1,697.4	0	160.5	36.1	1,894.0	8,668.8	10,562.8	8,944.7	37,178.8	5,308.1	24,403.6	68,508.6
20. Australia	301.3	546.0	0	176.5	1,023.8	2,278.0	3,301.8	3,766.7	12,318.3	2,163.5	5,680.7	19,697.6
21. New Zealand	13.3	49.2	43.9	0	106.4	939.6	1,046.0	1,091.1	3,057.2	644.6	1,229.4	4,886.1
ECAFE total	4,650.8	1,743.2	507.4	283.6	7,185.0	9,932.0	27,117.0	28,487.0	125,680.8	18,550.7	45,533.4	188,394.9
22. Others[b]	10,089.8	7,201.5	3,259.3	807.5	21,353.1							
Total imports[c]	14,740.6	8,944.7	3,766.7	1,091.1	28,543.1							

Notes: (a) Estimated figures based on past performance.
(b) Obtained as residual.
(c) Includes services.

Case 1[(a)]

Table 2: Projections of Inter-Country Relations of the Developing ECAFE Economy in 1970

At 1960 prices
(in million US dollars)

Imports from \ Exports to	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1. Afghanistan	0	0	0	0	0	0	0	10.2	0	0	0	0	0	0	2.8	0	0	0
2. Brunei	0	0	0	0	0	0	0.5	0	0	0	0	0	75.6	1.7	0	0	0	0
3. Burma	0	0	0	0	34.7	0	14.3	30.1	37.0	0.3	0.9	0	14.4	15.8	34.5	0	0	0
4. Cambodia	0	0	0	0	0	0	20.9	0.1	0.6	0	0	0	0.3	12.9	0	0	0	2.0
5. Ceylon	0	0	2.6	0	0	0	3.2	14.4	0	1.3	0	0	0	0.3	7.7	0	0	0
6. China (Taiwan)	0	0	0	0	0	0	61.9	0.3	0	4.5	16.3	0	7.6	11.9	0.3	6.7	19.5	30.8
7. Hong Kong	0	1.3	8.4	15.2	4.8	20.2	0	2.7	30.1	3.3	7.7	2.5	167.9	0	4.6	11.4	39.3	4.4
8. India	20.5	0	15.8	4.2	43.8	0	19.6	0	11.5	16.9	0	0	31.1	42.0	30.4	1.3	9.1	3.8
9. Indonesia	0	0	0.1	0	0.6	0	11.0	4.4	0	0.6	0	0	71.5	131.1	0.7	23.3	15.9	7.4
10. Iran	0	0	1.3	0	13.6	2.6	11.7	110.5	0	0	0	0	7.5	23.4	43.0	0.4	10.0	0.7
11. Korea, Rep. of	0	0	0	0	0	1.7	16.3	0	0	0	0	0	0	0.9	0	1.3	1.3	0.6
12. Laos	0	0	0	0	0	0	0.2	0	0	0	0	0	0	0	0	0	0.2	0
13. Malaysia	0	2.7	3.9	0.2	0	5.9	23.7	32.0	15.2	1.6	1.1	0	0	388.2	3.8	15.6	14.9	0.2
14. Singapore	0	10.5	5.1	4.2	6.8	4.6	56.8	19.2	96.3	2.8	9.1	0	597.9	0	7.4	7.2	55.8	3.6
15. Pakistan	2.7	0	11.1	7.5	6.0	0	29.4	42.7	0.2	3.1	0	0	2.6	1.4	0	2.1	0.4	0.7
16. Philippines	0	0	0.1	0	0	13.4	6.0	0.7	0.1	0	13.9	0	0.2	1.4	0.2	0	0.6	0.4
17. Thailand	0	0	0.1	0	6.4	11.3	107.7	4.7	40.2	0.4	1.1	11.1	111.5	68.6	0.5	11.0	0	3.1
18. Viet-Nam, Rep. of	0	0	0	1.4	1.9	1.7	12.2	0	0	0	0	0	1.5	0.7	0	30.2	0	0
Sub-total Developing ECAFE region	23.2	14.5	48.5	32.7	138.5	61.4	395.4	272.0	231.2	34.8	50.1	13.6	1,089.6	700.3	136.0	110.5	167.0	57.7
19. Japan	12.1	0.1	93.0	22.6	37.3	199.2	467.9	176.5	145.1	51.6	252.4	2.9	70.2	183.1	85.9	134.6	292.0	77.0
20. Australia	0	0	9.3	0	20.5	15.6	110.4	61.9	9.9	7.3	9.5	0	52.4	63.0	18.7	17.9	14.6	2.6
21. New Zealand	0	0	0	0	0.8	0	3.2	4.7	0	0	0	0	6.2	0.9	0	2.0	0	0
ECAFE total	35.3	14.6	150.8	55.3	177.3	276.2	976.9	515.1	386.2	93.7	312.0	16.5	1,218.4	947.3	240.6	305.0	473.6	137.3
22. Others[(b)]	165.6	29.3	191.1	143.5	358.9	753.8	1,196.8	3,015.8	490.2	934.1	548.2	27.9	400.1	701.5	1,467.3	975.8	772.0	645.9
Total imports[(c)]	200.9	43.9	341.9	198.8	536.2	1,030.0	2,173.7	3,530.9	876.4	1,027.8	860.2	44.4	1,618.5	1,648.8	1,707.9	1,280.8	1,245.6	783.2

Notes: (a) Projections based on past performances.
(b) Obtained as a residual.
(c) Includes services.

Table 2: Projections of Inter-Country Relations of the Developing ECAFE Economy in 1970 (continued)

Case I[a]

Imports from \ Exports to	Sub-total developing ECAFE	19	20	21	Total ECAFE	22	Total exports	Total imports	Consumption expenditure Private	Consumption expenditure Government	Gross domestic capital product	Gross domestic product
1. Afghanistan	13.0	0	0	0	13.0	84.8	97.8	200.9	1,398.1	168.9	241.4	1,705.3
2. Brunei	74.8	0	0.2	0	75.0	0.6	75.6	43.9	86.5	19.6	34.8	172.6
3. Burma	182.1	24.5	0	0	206.6	154.9	361.5	394.9	1,483.2	339.8	462.1	2,251.7
4. Cambodia	36.8	2.8	0	0	39.6	202.2	241.8	242.0	687.1	182.2	149.1	1,018.2
5. Ceylon	29.5	16.6	31.3	12.6	90.0	460.1	550.1	536.2	1,289.5	251.0	288.4	1,842.8
6. China (Taiwan)	159.8	140.8	1.8	0.5	302.9	657.5	960.4	1,030.0	2,267.2	666.6	663.8	3,528.0
7. Hong Kong	323.8	87.1	30.2	12.2	453.3	1,522.2	1,975.5	2,173.7	2,503.9	213.9	599.8	3,119.4
8. India	250.0	17.7	56.3	22.0	346.0	2,284.8	2,630.8	3,530.9	36,573.2	4,745.0	8,301.0	48,719.1
9. Indonesia	266.6	105.9	76.1	4.4	453.0	410.6	863.6	876.4	9,573.2	1,635.6	646.6	11,842.6
10. Iran	224.7	160.3	71.0	7.2	463.2	1,327.2	1,790.4	1,027.8	4,158.0	1,178.2	1,298.1	7,396.9
11. Korea, Rep.of	22.1	44.6	0	0	66.7	669.5	736.2	860.8	5,682.3	672.6	1,160.4	7,390.7
12. Laos	0.4	0	0	0	0.4	0.8	1.2	44.4	245.0	31.8	37.2	270.8
13. Malaysia	509.0	364.2	53.0	5.1	931.3	826.9	1,758.2	1,618.5	2,143.3	811.5	750.4	3,844.9
14. Singapore	887.3	101.7	41.3	18.0	1,048.3	600.7	1,649.0	1,648.8	1,029.6	154.5	287.0	1,471.3
15. Pakistan	109.9	59.0	18.8	8.9	196.6	523.1	719.7	1,707.9	9,766.4	1,587.4	2,149.4	12,525.0
16. Philippines	37.0	302.0	2.5	0.3	341.8	832.8	1,174.6	1,280.8	4,098.9	500.3	653.1	5,146.1
17. Thailand	377.7	170.8	1.2	0	549.7	504.7	1,054.4	1,245.6	3,925.2	542.8	1,301.1	5,577.9
18. Viet-Nam, Rep. of	49.6	5.7	0	0	55.3	221.0	276.3	783.2	3,088.7	875.3	439.4	3,896.5
Sub-total Developing ECAFE region	3,554.1	1,603.7	383.7	91.2	5,632.7	11,284.4	16,917.1	19,246.7	89,[illegible]9.3	14,587.0	19,463.1	121,719.8
19. Japan	2,343.5	0	203.8	46.5	2,593.8	15,355.0	17,948.8	16,844.6	55,810.9	7,689.8	42,252.1	106,857.0
20. Australia	413.7	851.6	0	226.6	1,491.9	3,518.4	5,010.3	5,077.7	15,520.6	2,694.1	6,872.9	25,020.2
21. New Zealand	17.8	73.7	55.0	0	146.5	1,160.2	1,306.7	1,300.6	3,837.5	847.8	1,604.3	6,295.7
ECAFE total	6,329.1	2,529.0	642.5	364.3	9,864.9	31,318.0	41,182.9	42,469.6	165,168.3	25,818.7	70,192.4	259,892.7
22. Others[b]	12,917.6	14,315.6	4,435.2	936.3	32,604.7							
Total Imports[c]	19,246.7	16,844.6	5,077.7	1,300.6	42,469.6							

Note: (see first page)

Case II[(a)]

Table 3: Projections of Inter-Country Relations of the Developing ECAFE Economy in 1970

At 1960 prices (in million US dollars)

Imports from \ Exports to	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	Sub-total developing ECAFE
1. Afghanistan	0	0	0	0	0	0	0	11.1	0	0	0	0	0	0	2.8	0	0	0	13.9
2. Brunei	0	0	0	0	0	0	0.5	0	0	0	0	0	75.6	1.7	0	0	0	0	77.8
3. Burma	0	0	0	0	44.7	0	14.3	32.8	42.6	0.3	0.9	0	14.3	15.8	34.5	0	0	0	200.2
4. Cambodia	0	0	0	0	0	0	20.9	0.1	0.7	0	0	0	0.3	12.9	0	0	0	2.1	37.0
5. Ceylon	0	0	2.7	0	0	0	3.2	25.7	0	1.4	0	0	0	0.3	7.7	0	0	0	41.0
6. China (Taiwan)	0	0	0	0	0	0	61.9	0.3	0	4.7	16.1	0	7.5	11.8	0.3	6.9	19.1	31.2	159.8
7. Hong Kong	0	1.3	8.8	19.4	6.1	18.8	0	3.0	36.7	3.4	7.6	2.5	166.1	0	4.6	11.8	38.5	4.4	333.0
8. India	20.6	0	16.6	5.4	56.4	0	19.6	0	13.2	17.7	0	0	30.8	41.8	30.2	1.4	8.9	3.8	266.4
9. Indonesia	0	0	0.2	0	0.8	0	11.0	4.8	0	0.6	0	0	70.7	130.4	0.7	23.9	15.5	7.5	266.1
10. Iran	0	0	1.3	0	17.5	2.4	11.7	120.6	0	0	0	0	7.4	23.3	42.8	0.4	9.8	0.7	237.9
11. Korea, Rep. of	0	0	0	0	0	1.6	16.3	0	0	0	0	0	0	0.9	0	1.4	1.3	0.6	22.1
12. Laos	0	0	0	0	0	0	0.2	0	0	0	0	0	0	0	0	0	0.2	0	0.4
13. Malaysia	0	2.8	4.0	0.2	0	5.5	23.7	34.9	17.5	1.7	1.1	0	0	386.4	3.8	16.1	14.6	0.1	512.4
14. Singapore	0	10.6	5.4	5.4	8.7	4.3	56.8	21.0	110.8	3.0	9.0	0	591.6	0	7.4	7.4	54.6	3.7	899.7
15. Pakistan	2.7	0	11.7	9.6	7.8	0	29.4	46.6	0.3	3.3	0	0	2.6	1.4	0	2.2	0.4	0.7	118.7
16. Philippines	0	0	0.2	0	0	12.4	6.0	0.7	0.1	0	13.8	0	0.2	1.4	0.2	0	0.6	0.4	36.0
17. Thailand	0	0	1.5	0	8.2	10.5	107.7	5.1	46.2	0.5	1.1	11.1	110.3	68.2	0.5	11.4	0	3.1	385.4
18. Viet-Nam, Rep. of	0	0	0	1.7	2.5	1.6	12.2	0	0	0	0	0	1.4	0.7	0	3.1	0	0	23.2
Sub-total Developing ECAFE region	23.3	14.7	52.4	41.7	152.7	57.1	395.4	296.7	266.1	36.6	49.6	13.6	1,078.8	697.0	135.5	86.0	163.5	58.3	3,619.0
19. Japan	12.1	0.1	97.7	28.8	48.0	184.9	467.9	192.4	167.0	54.1	250.1	2.9	69.4	182.2	85.5	179.6	286.0	78.1	2,386.8
20. Australia	0	0	9.7	0	26.6	14.5	110.4	67.5	11.4	7.7	9.4	0	52.8	62.7	18.6	18.4	14.3	2.7	425.7
21. New Zealand	0	0	0	0	1.0	0	3.2	5.1	0	0	0	0	6.1	0.9	0	2.2	0	0	18.5
ECAFE total	35.4	14.8	159.8	70.5	228.3	256.5	976.9	561.7	444.5	98.4	309.1	16.5	1,206.1	942.8	239.6	286.2	463.8	139.1	6,450.4
22. Others[(b)]	169.9	29.8	192.5	183.2	330.4	534.4	1,446.1	2,858.2	1,042.3	1,484.6	1,196.8	28.1	400.1	702.3	1,034.5	1,045.4	753.2	665.3	13,266.8
Total imports[(c)]	205.3	44.6	352.3	253.7	558.7	790.9	2,423.0	3,419.9	1,486.8	1,583.0	1,505.9	44.6	1,606.2	1,645.1	1,274.1	1,331.6	1,217.0	804.4	19,717.2

Notes: (a) Projections based on modified parameters in accordance with planned targets.
(b) Obtained as a residual.
(c) Includes services.

Table 3: Projections of Inter-Country Relations of the Developing ECAFE Economy in 1970 (continued)

Case II[(a)]

At 1960 prices
(in million US dollars)

Imports from / Exports to	19	20	21	Total ECAFE	22	Total exports	Total imports	Consumption expenditure: Private	Consumption expenditure: Government	Gross domestic capital product	Gross domestic product
1. Afghanistan	0	0	0	13.9	81.8	95.7	205.3	1,405.8	170.4	246.7	1,713.3
2. Brunei	0	0.2	0	78.0	11.2	89.2	44.6	87.6	20.0	22.9	175.1
3. Burma	24.0	0	0	224.2	146.1	370.3	352.3	1,480.7	359.6	501.1	2,359.4
4. Cambodia	2.7	0	0	39.7	229.8	269.5	253.7	963.4	158.5	161.9	1,299.6
5. Ceylon	16.3	31.4	12.9	91.6	477.0	568.6	558.7	1,584.8	311.5	468.3	2,374.5
6. China (Taiwan)	138.3	1.9	0.5	300.5	602.8	903.3	790.9	2,009.5	559.2	593.9	3,275.0
7. Hong Kong	85.5	30.3	12.4	459.2	1,524.6	1,983.3	2,423.0	2,631.1	239.1	688.9	3,119.4
8. India	17.4	56.6	22.6	363.0	2,354.1	2,817.1	3,419.9	38,710.4	5,385.1	9,644.3	53,137.0
9. Indonesia	103.9	76.4	4.4	450.8	531.0	981.8	1,486.8	10,706.5	1,928.9	1,499.3	13,629.7
10. Iran	157.4	71.3	7.4	474.0	1,324.1	1,798.1	1,583.0	4,886.0	1,259.9	1,396.5	7,757.5
11. Korea, Rep. of	43.8	0	0	65.9	1,260.5	1,326.4	1,505.9	5,062.6	1,095.5	1,363.3	7,321.9
12. Laos	0	0	0	0.4	12.4	12.8	44.6	228.0	30.0	45.9	272.1
13. Malaysia	357.6	53.2	5.2	928.4	826.7	1,755.1	1,606.2	2,116.1	796.4	742.7	3,804.1
14. Singapore	99.9	41.5	18.4	1,059.5	628.3	1,687.8	1,645.1	1,011.5	153.8	256.3	1,464.3
15. Pakistan	58.0	18.9	9.1	204.7	537.6	742.3	1,274.1	9,254.5	1,393.8	2,349.9	12,466.4
16. Philippines	296.5	2.5	0.3	335.3	1,113.5	1,448.8	1,331.6	3,900.4	517.7	758.8	5,294.1
17. Thailand	167.7	1.2	0	554.3	525.4	1,079.7	1,217.0	3,944.8	531.2	1,123.6	5,462.3
18. Viet-Nam, Rep. of	5.6	0	0	28.8	334.6	363.4	804.4	3,192.9	726.5	474.2	3,952.6
Sub-total Developing ECAFE region	1,574.6	385.4	93.2	5,672.2	11,621.0	18,293.2	20,547.1	93,156.6	15,637.1	22,338.5	128,878.3
19. Japan	0	204.8	47.6	2,639.2	15,355.0	17,994.2	16,372.4	54,376.6	6,080.1	41,895.5	103,974.0
20. Australia	836.2	0	232.1	1,494.0	3,531.1	5,025.1	5,107.2	15,425.1	2,706.1	7,090.6	25,140.0
21. New Zealand	72.3	55.2	0	146.0	1,211.1	1,357.1	1,323.0	3,999.5	869.6	1,543.5	6,446.7
ECAFE total	2,483.1	645.4	372.9	9,951.4	32,718.2	42,669.6	43,349.7	166,958.1	25,292.9	72,868.1	264,439.0
22. Others[(b)]	13,089.3	4,461.8	950.1								
Total imports[(c)]	16,372.4	5,107.2	1,323.0								

Notes: (a) Projections based on modified parameters in accordance with planned targets.
(b) Obtained as a residual.
(c) Includes services.

Table 4 Annual Growth Rates of GDP of the Developing Countries in the ECAFE Region

Unit: %

Country	Past performance				Planned				Projected(b)		
	Period	Growth(a) rate	Period	Growth(a) rate	Period	Growth(b) rate	Period	Growth(b) rate	Case I 1960-65	Case I 1965-70	Case II 1965-70
1. Afghanistan	1950-60	..	1960-65	..	..	..	..	..	5.9	5.9	6.0
2. Brunei	1950-60	..	1960-65	..	..	..	..	..	4.5	4.7	5.0
3. Burma	1951-60	5.4	1960-64	3.1	1960-65	5.9	1966-75	..	3.1	5.4	5.9
4. Cambodia	1950-60	..	1960-65	4.7	1960-65	5.0	1965-70	5.0	4.7	4.9	5.0
5. Ceylon	1950-60	3.4	1960-64	2.2	1958-68	6.0	1965-71	5.2	2.8	3.4	5.2
6. China (Taiwan)	1951-60	7.0	1960-63	7.1	1960-65	8.0	1965-68	7.0	8.7	7.1	7.0
7. Hong Kong	1950-60	..	1960-64	12.3	1960-65	..	1965-70	..	12.3	9.6	9.6
8. India	1950-60	3.6	1960-64	3.8	1960-65	5.1	1965-70	5.5	4.0	4.1	5.5
9. Indonesia	1950-60	..	1960-64	0.6	1960-65	..	1965-70	..	1.4	2.1	5.0
10. Iran	1950-60	..	1960-64	5.4	1960-65	..	1965-70	6.0	5.4	5.4	6.0
11. Korea, Rep. of	1953-60	5.2	1960-65	7.2	1963-66	5.0	1967-71	7.0	7.2	7.2	7.0
12. Laos	1950-60	..	1960-65	..	1960-65	..	1965-70	..	4.7	4.9	5.0
13. Malaysia	1955-60	3.6(c)	1960-65	6.0(c)	1960-65	4.4(c)	1965-70	4.9	6.0	6.1	6.1
14. Singapore	1950-60	..	1960-65	7.5	1960-65	7.3-7.8	1966-70	7.0	7.5	7.1	7.0
15. Pakistan	1950-60	3.3	1960-65	5.8	1960-65	5.2	1965-70	6.5	5.8	6.6	6.5
16. Philippines	1952-60	4.9	1960-65	4.8	1963-67	6.1	1965-67	6.1	4.8	5.4	6.1
17. Thailand	1957-60	7.4	1960-65	7.3	1960-65	5.0	1966-71	8.5	7.3	8.9	8.5
18. Viet-Nam, Rep. of	1950-60	..	1960-65	4.9	1960-65	..	1965-70	..	4.9	4.7	5.0
Total developing ECAFE region	1950-60	3.9(d)	1960-65	4.1(d)	1960-65	5.7(d)	1965-70	6.2(d)	4.4	5.0	6.2
19. Japan	1950-60	9.8	1960-65	9.4	1960-66	8.1	1965-71	8.2	9.4	9.3	8.7
20. Australia	1953-60	4.0	1960-64	4.6	1960-65	..	1965-70	..	4.7	4.9	5.3
21. New Zealand	1953-60	4.4	1960-64	5.1	1960-65	..	1965-70	..	5.1	5.2	5.7

Notes: (a) Estimated by the least squares.
(b) Annual average growth rates.
(c) State of Malaya only.
(d) Approximate figures.
(e) Projections based on past performance.
(f) Projections based on planned targets.

TABLE 5. Projections of key variables of the Japanese economy in 1970

At 1960 prices
(in thousand million yen)

Case 1. Assuming Japan's financial aid to the developing countries amounted to 1 percent of its national income with trade expansion effects.[1]

Variables \ Sector	Total	1 Agri-culture, fores-try & fishing	2 Mining	3 Other manufac-turing than Sector 4	4 Machi-nery, metals, chemi-cals	5 Con-struc-tion	6 Electricity gas, water, transporta-tion & communica.	7 Services and others
x : Gross industrial output	91610.8	5293.2	203.1	20456.1	32601.0	8854.2	6048.8	17654.5
v : Gross value added[2]	37916.7	3644.5	512.0	5755.0	9689.0	2263.2	4260.1	11792.7
w : Compensation of employees	11017.5	-	178.8	1878.1	2415.4	1144.8	1645.2	3935.3
z : Gross business surplus	22461.7	3042.3	215.3	3406.3	6145.1	944.2	1730.6	6978.0
d : Depreciation allowance	4035.8	200.5	118.0	470.6	1128.8	174.2	1064.4	879.3
l : Labour employed (thousand employees)	51027.3	10546.8	441.6	8525.6	7657.8	4473.0	2921.2	16461.9
w : Average wage rate (thousand mil'ion yen/thousand employees)		-	0.40	0.22	0.32	0.26	0.50	0.24
Δ s : Gross fixed capital formation by sector	8995.4	194.9	356.8	1445.2	2431.7	259.0	2855.0	1452.8
s : Gross fixed capital stock by sector	61034.6	4066.5	2133.2	8930.5	16722.6	1140.3	18938.5	9102.9
c : Private final consumption expenditure	16680.9	986.9	54.4	7097.2	1502.0	-	1392.9	5343.7
g : Government final consumption expenditure	4126.1	2.5	4.1	68.9	201.4	16.1	146.1	3687.9
Δ sf: Gross fixed capital expenditure for final use	8995.4	29.3	-	43.3	3355.1	5162.1	25.3	317.9
Δ s_i: Increase in inventories	713.6	251.4	17.2	265.9	163.0	-	5.4	10.6
e : Exports	5497.7	109.0	-	1743.7	2875.8	1.1	333.7	434.3
m : Imports	5027.5	1261.6	1146.0	665.3	1716.6	-	122.9	115.1
p_x : Export price indexes (1960=100)		100.0	100.0	88.7	93.6	-	-	-
p_m : Import price indexes (1960=100)		100.0	100.0	100.0	100.0	-	-	-
b : Trade balance	470.2							
l : Economic aid	292.8							
r : Government current revenue	9050.6							

Notes: (1) For the purpose of projection, the estimated parameters derived from time series data, 1951-1963 are used without any modification except the ratio of aid to the national income. For the last decade Japan's export elasticities to the developing countries in relation to its financial aid are estimated to be around 0.2-0.3 depending on export sectors.

(2) An estimated annual average growth rate of GNP is approximately 8.7 per cent for the period of 1963-1970.

TABLE 6. Projections of key variables of the Japanese economy in 1970

At 1960 prices
Thousand million yen

Case 2. Assuming Japan's financial aid to the developing countries amounted to 1 percent of its national income without trade expansion effects.[1]

Variables \ Sector	Total	1 Agri-culture, fores-try & fishing	2 Mining	3 Other manufac-turing than Sector 4	4 Machi-nery, metals, chemi-cals	5 Con-struc-tion	6 Electricity gas, water, transporta-tion & communica.	7 Services and others
x : Gross industrial output	80321.3	4932.5	638.5	18344.2	27115.0	7687.0	5401.3	16202.8
v : Gross value added	33690.1	3386.4	459.7	5137.5	8031.9	2002.0	3787.8	10884.8
w : Compensation of employees	10145.5	-	171.6	1725.0	2156.9	1000.1	1351.5	3740.4
z : Gross business surplus	19465.9	2835.6	178.7	2968.8	4918.6	842.2	1430.6	6291.4
d : Depreciation allowance	3727.6	199.7	109.3	443.7	956.4	159.7	1005.7	853.1
l : Labour employed (thousand employees)	49098.7	10546.8	441.6	8135.9	7011.5	4187.0	2835.1	15940.8
w : Average wage rate (thousand million yen/thousand employees)		-	0.39	0.21	0.31	0.24	0.48	0.23
Δ s : Gross fixed capital formation by sector	7575.8	189.3	303.7	1265.2	1791.7	218.8	2475.5	1331.7
s : Gross fixed capital stock	56387.6	4050.8	1977.3	8419.1	14169.2	1045.2	17894.8	8831.3
c : Private final consumption expenditure	15432.1	921.4	48.1	6548.5	1344.7	-	1267.1	5032.8
g : Government final consumption expenditure	3779.4	2.3	3.8	63.1	184.4	14.7	133.8	3378.0
Δs_f : Gross fixed capital expenditure for final use	7534.5	24.1	-	37.9	2794.6	4392.4	21.3	264.1
Δs_i : Increase in inventories	638.6	234.3	15.6	238.5	135.6	-	4.9	9.7
e : Exports	4055.8	94.7	-	1463.3	1728.7	1.1	333.7	434.3
m : Imports	4316.8	1127.9	970.7	588.4	1391.9	-	122.9	115.1
p_x : Export price indexes (1960=100)		100.0	100.0	89.6	93.8	-	-	-
p_m : Import price indexes (1960=100)		100.0	100.0	100.0	100.0	-	-	-
b : Trade balance	-261.0							
l : Economic aid	260.2							
r : Government current revenue	7974.7							

Notes: (1) For the particular purpose of projection, Japan's export elasticities to the developing countries in relation to its financial aid are intendedly assumed to be zero for all export sectors.

(2) An estimated annual average growth rate of GNP is approximately 7.5 percent for the period of 1963-1970.

SESSION VI

Comment on G. Ranis' Paper by Yoichi Itagaki

I would like to make some comments on Prof. Ranis' paper which presented a comprehensive and clear picture of the United States' aid policies in Asia. In his paper, Prof. Ranis attempted to make clear the United States' major aid objectives, classifying them into two categories: first, security and stability objectives which are considered to be of overriding importance to recipient countries on the periphery of the Communist bloc, and second, economic and social development objectives, which are considered to be of paramount importance to all other recipient countries. He then proceeded to show, analysing statistical evidence, that the United States aid programme shifted its emphasis from military assistance in the early 1950's to economic assistance in the early 1960's.

Through these observations, Prof. Ranis confirmed that the first group of countries, such as Taiwan and Korea, have achieved great success in their economic development, after being assured security and stability, and "graduated" from the role of aid recipients by the mid 60's. In this sense, United States' objectives have been successfully attained.

On the other hand, taking cases of India and Pakistan which belong to the second group of countries, Prof. Ranis tried to show that Pakistan in particular, has achieved remarkable success in its economic development, while India suffered some difficulty in realising the targets of successive five-year plans and lagged behind Pakistan economically. But all in all, Prof. Ranis is inclined to take the view that United States aid objectives for development proved on the whole successful in the case of these two countries.

In this connection I would like to make two points. The first point concerns Prof. Ranis' understanding of the cause of successful development in Taiwan and Korea. Needless to say, the role played by the United States' aid in the establishment of security and stability for the countries concerned was extremely important. However, it does not always follow that a country, after being assured its security, will automatically take off into self-sustained economic growth. Besides security and stability, there must be some other co-operating conditions which make economic development itself possible.

In this regard, Prof. Ranis stressed the importance and the effectiveness of the "policy package" approach taken by the United States and adopted by successive Taiwan governments. I admit the importance of this approach. But, in addition, I would stress that there were other social conditions of importance which contributed to Taiwan's economic performance.

To my way of thinking, the comparatively high level of educational attainment of the Taiwanese people, in terms of literacy and so on, was one of the crucial factors in increasingly successful economic activity. And the case of Korea is more or less the same as that of Taiwan.

The second point is related to Prof. Ranis' rather optimistic evaluation of the degree of economic development of, and future prospects for, Pakistan and India. With regard to Pakistan, I have almost no objections to the trend of Prof. Ranis' argument about the effects of United States' aid nor to his evaluation of Pakistan's economic performance. And I also accept that Pakistan's achievements have been substantially superior to those of India, at least since the early 1960's.

In contrast, it seems to me that India has been facing the tremendous difficulties not easily overcome for many years. Indian authorities are now going to attempt to change their policy orientation in view of their assessment of the causes of the economic crisis which was brought about by too hasty an industrialization policy. The start of the 4th five-year plan, which was to begin in the year of 1967, will be delayed until 1969. In many respects, such as food shortage, stagnation of industrial production and exports, chronic balance of payment deficits, huge accumulated foreign debts, and population pressure, India is involved in a lot of economic difficulties which cannot be overcome at present levels of foreign aid. She would need huge amounts of aid to sustain growth successfully. In this sense, I am rather pessimistic about India's economic prospects. And also, viewed from political point of view, there are hardly any grounds for optimism about national consolidation and political stability in post-Nehru India in view of the results of the general election early last year. In short, it was my general impression that Prof. Ranis' view of future outlook for India is too optimistic.

There are several brief comments I would also like to make. The third point is related to the "policy package" approach which is supported by Prof. Ranis. This approach should be carried out very carefully on the part of donor countries, for the reason that this sort of approach is a delicate and difficult business as Prof. Ranis fully recognizes.

Talks between donor and recipient countries will never be entirely free from the threat of intervention in the internal affairs of recipient countries because of the differences in power position. Therefore, the "policy package" approach should be undertaken best on the basis of multilateral arrangements, so as not to induce feelings of reaction and nationalism on the part of recipient countries.

Fourth, there is the question of food surplus assistance in a form of P.L. 480. There is little doubt that countries which received this type of aid derived much benefit from it. There are, however, some people who contend, paradoxically, that this kind of assistance disrupted and discouraged efforts to increase agricultural productivity in India. Unfortunately I cannot say 'yes or no' to this criticism since I have not yet studied the problem. But, could it be accepted merely as a necessary evil of granting P.L. 480 assistance?

Fifthly, there is the problem of wider participation by millions of "little men or little people" in the development process through focussing on the agricultural sector and on the "starved" medium-scale entrepreneurs outside of agriculture. I am of the same opinion as Prof. Ranis, but it seems to me that he has neglected the crucial issue of how "little people" can be mobilized toward that direction. He only asserts that "little people" can be mobilized from below by means of appeal to their private profit motives in the market place. At this point, I must part company with Prof. Ranis, for the reason that it seems unlikely that private profit motives can be relied upon in the early pre-take-off stages of development. Probably some sort of government intervention is necessary. In reality, mutual co-operation between government officials and local "little people" will be necessary. For this very reason I am uneasy about the possibility, for instance, of the Indian Administrative Service behaving just like rulers patterned on the former Indian Civil Service and not like humble public servants. In this event, the desired co-operation would not result. The gap between government servants and "little people" may not be so easily bridged. The problem of the mobilisation of millions of "little people" from below as well as from above seems a very difficult one.

Finally, I must make a few comments on the big problem of regional co-operation in Southeast Asia taken up by Prof. Ranis. This problem is thought by him as a second major pillar of U.S. assistance policy in Asia. In his opinion, regional approaches to development should not be doctrinaire, but pragmatic. I agree with Prof. Ranis' "concept of pragmatic regionalism". He cited a number of co-operative projects in Southeast Asia which point the way. If efforts for regional co-operation involving planning for development, trade, and aid aspects succeeded, there are bright prospects for the economic development of Southeast Asian countries. At the moment, however, it must be frankly admitted that the case for regionalism is not strong enough to overcome the still powerful influence of nationalistic ideas. Even so, it certainly may be said that regional co-operation has already become a matter of common concern of developing countries in Southeast Asia. And it is worthy of note that with the voluntary co-operation of five countries (Indonesia, Singapore, Malaysia, Thailand and the Philippines) the Association of Southeast Asian Nations (ASEAN) was founded in August, 1967 as an organizational setup for sub-regional economic and cultural co-operation. It is a hopeful sign, but I am not well enough informed of the scope and direction of its activities. With regard to this point, I am happy to hear from Dr. Jones, the former U.S. Ambassador to Indonesia who was in the service there for seven years, that Indonesia took initiative in the establishment of ASEAN. I hope this important problem of regionalism in Asia will be discussed again in connection of Dr. Okita's paper.

Comment on S. Okita and A. Ohnishi's Paper by Authur Paul

Just before the adjournment of this morning's session, I intervened in the discussion to say that before the conclusion of the conference, I wanted to address a few words to one particular aspect of the matters we have been discussing. These remarks, I said, would be made from the point of view of the developing countries of Asia. I explained that when Dr. Okita and Professor Kojima had talked with me last October about the possibility of my participating in this Conference, I had said that, if I did attend, I would like, to consider and to discuss the proposals and the papers that would be submitted to the Conference from the point of view of the developing nations of Asia. I explained that my work for the last seven or eight years had been as an economic adviser to several of the smaller Asian countries. Therefore, I felt that my chief contribution to the meeting and my main field of competence might be to reflect the attitudes and to anticipate the reactions of those Asians who are struggling with the difficult tasks of planning and administering economic development programmes in the developing countries of Asia.

I include this explanation of my present remarks because I want Dr. Okita to understand why my comments on his important paper are briefer and more general than would have been the case if there had been time for me to have made my other comments during the morning session.

More than any other paper submitted at this Conference, Dr. Okita's deals with the question of joint or co-ordinated policies and programmes of assistance to the developing countries by the five developed countries of the Pacific area. It is for that reason that I consider it to be one of the most significant of the papers that we have considered. Although two themes were proposed for this Conference, the discussion up until this final session has concentrated on the first theme which is consideration of the desirability and the feasibility of steps that might be taken toward the establishment of a free trade area in the Pacific. The second theme which is coordination of aid policies and the creation of aid programmes to be jointly sponsored by the developed nations of the Pacific, in my opinion, deserves equal, if not prior, treatment. Therefore it was gratifying to find this subject stressed in Dr. Okita's paper and also to find certain aspects of it skillfully analysed in considerable detail in Mr. Onishi's supplementary appendix to the paper.

In this connection I would like to suggest that in whatever public announcement is made at the conclusion of this meeting the importance of the second theme of the Conference should be stressed. This will help to offset misconceptions regarding our discussions from arising in the minds of persons in the developing countries who are concerned with these subjects.

This brings me to the question of the prevailing attitude held by many Asian officials and economists on these matters. Since my talks with Dr. Okita and Professor Kojima in October I have visited a number of the developing countries of Asia and I have had many conversations on this subject. Frankly I was very much concerned, but, on the whole not greatly surprised, to find how strongly opposed many persons were to the proposals we have been discussing. In some cases the opposition was intense and, in my opinion, to some extent irrational. But whether rational or not these feelings exist and it behoves us to take them fully into consideration. Furthermore, some of the opposition was based on quite valid and fully rational grounds.

There are a number of specific points that I could cite in order to give substance to the nature of the opposition to the proposals, but I shall concentrate my remarks on one of them. What I have in mind is ECAFE's proposal to establish some form of payments arrangement among the member countries of that area. This proposal, which is an important part of ECAFE's efforts to promote trade liberalization among the less developed countries of Asia, has gone ahead more rapidly than was originally expected. Detailed factual studies have been made of what would be the effect of pooling the trade balance of the ECAFE countries and of what the benefits of a clearing arrangement might be. At a meeting held in Bangkok last August, a plan prepared by Professor Robert Triffin was considered by a group of monetary experts from the region and plans for the next steps to be taken were formulated. These have now been submitted to the member countries. A second meeting on this proposal is planned for this summer at which the direct relationship of trade liberalization to the payments plan will be considered. At this meeting an effort will be made to devise a set of minimum standards for trade regulations and for control practices that would have to be adopted before a country could qualify as a member of the proposed clearing union.

One of the by-products of the examination of the feasibility and the usefulness of creating some form of payments arrangement in Asia has been the way in which it has brought out into the open what must be faced up to by those countries who would be the persistent creditors of the prospective clearing union and whose balance of payments difficulties are greatest. These countries, none of whose currencies are convertible, are among those who are most anxious to take advantage of whatever benefits can be achieved by multilateral clearing of their trade balances with neighbouring countries who are in many cases their most natural trading partners. But the countries with more stable currencies are not themselves going to join in any clearing arrangement, especially one which might extend even modest credits, until those who are in persistent difficulties are willing to impose restraints on their trade practices and to introduce sufficient internal financial discipline so that if assistance is given to their current problems there will be some assurance of a future solution to them. Incidentally I might mention that this is the kind of pressure that bilateral aid donors have wanted for a long time to exert, but which has frequently led to difficult relationships with aid-receiving countries. It is far easier for a developing country of Asia to accept joint pressure from a neighboring group of Asian countries, especially if there would be immediate trade advantages in doing so.

What is needed now for ECAFE's proposals to move ahead more rapidly is Japanese and Australian participation in the plan, plus some gesture of endorsement or support by the United States. But what we have been discussing here has been a clearing arrangement between the developed nations of the Pacific area, all of whose currencies are fully convertible and for whose benefit highly efficient and low cost commercial clearing facilities already exist. This seems to me to be an inward looking step. Taken in combination with the lack of interest and of support given so far by the developed countries of the Pacific to the ECAFE proposals, this set of circumstances would appear to be a good and sufficient reason justifying adverse reactions of the developing countries of Asia to the general nature of the proposals we have been considering.

Another matter of concern to the developing countries of Asia is the possible effect of an economic grouping of Pacific countries toward increasing their support and widening the scope of the functions of the Asia Development Bank. Discussion of the formation of a separate Development Bank on the part of the developed countries of the area again is an inward looking step which is bound to be disturbing to the developing countries of the area.

For these reasons I feel that it is of great importance that the attitudes of the developing countries should be given serious consideration before further steps toward closer economic relationships are taken by the developed countries of the Pacific area. For the same reasons I also feel that the second theme of the Conference, which is the creation of joint or coordinated policies and programs of aid, should be given priority over considerations pertaining to the Pacific Free Trade Area.

Aside from these questions of emphasis and priority, there are some general remarks I want to make at this time. My initial thoughts regarding the desirability of formalizing closer economic ties between the developed countries of the Pacific were mixed and were partly conditioned by my close association with the problems of the developing countries of Asia. But the more deeply I considered the matter and the more closely I have studied the earlier papers as well as those submitted to this gathering, the more important the potential benefits appear to be.

If the next steps that are taken are "outward" looking and if the organizational proposals are "open-ended" in structure, then I believe it will be highly desirable to continue the explorations started at this Conference. In regard to the question of timing and the readiness of various countries for steps of this nature, I would like to say that I have been greatly impressed with the rapidity with which attitudes are changing in developed countries especially in regard to protectionism. This is partly due to the rate of technological change in industrial equipment and in methods of agriculture. I have a feeling that a few years from now our analytical work will be more devoted to calculations of how the impacts of technological change and synthetic products can be eased than to changes in tariff schedules. Dynamic factors present grave difficulties in judging projections of the kind we have been reviewing.

In conclusion I want to apologize to Dr. Okita for having used this time for a discussion of some matters only indirectly related to his paper. I concur with his general conclusions and I was particularly interested in the tables prepared by Mr. Ohnishi which throw new light on some of the subjects we have been discussing.

Discussion on Ranis' and Okita-Ohnishi's Papers

In reply Prof. Ranis took up the three main points raised by Prof. Itagaki. First, he expressed optimism about the "policy package" adopted by India since devaluation of the rupee in 1966. Import liberalisation and normal monsoon conditions give promise of improved Indian performances. Second, he suggested that PL 480 assistance could no longer be thought of as a "necessary evil", since United States' food surpluses had been used up. It now constituted genuine assistance to countries facing food crises. Third, Prof. Ranis agreed fully that the problem of mobilising "little peoples" to the development objective was not easily solved and that governments must play an active part in the process. However, he was concerned that governments intervene to create more perfect markets and utilize market incentives more effectively rather than try to substitute for market forces.

Dr. Okita agreed completely with the remarks made by Mr. Paul, emphasizing that due regard must be paid to the opinion expressed by people from developing nations. He went on to suggest that it would be better to invite economists from developing countries to any future meetings and discuss with them the possibilities for regional co-operation in the Pacific and Asian region. He also agreed that much weight should be placed on joint aid efforts by advanced Pacific countries.

Further discussion was adjuourned until Session VII.

SESSION VII

Summary of Discussion Sessions I--VI by Harry G. Johnson

The Conference set out to discuss the possibilities for freer trade in the Pacific Region, and the possibilities of combining this, in the first instance, with assistance to the developing countries of Asia. In the forefront was the notion of the Pacific Free Trade Area, but this, I think, was regarded by all of us as an organizing theme rather than as a specific practical possibility which we would discuss in detail.

At the end of discussion we have arrived at some general ideas of the positions and interests of the various countries in freer Pacific trade and in the possibilities of a Pacific Free Trade Area. To my mind, one of the most interesting things which has emerged from the discussion has been that the economists from Canada, Australia, and New Zealand have arrived in their thinking about national trade policy at much the same point. That is, they have arrived at the conclusion that the protectionist policies followed up to now have resulted in the creation of high cost, inefficient, excessively diversified industries, and that their economies are sufficiently industrialized (perhaps with some reservations about New Zealand, but certainly not about Australia and Canada), sufficiently efficient, and sufficiently armed with capital, skilled labour, and technology, that they can contemplate taking a major step forward into the world economy. They have the capacity to be efficient industrial producers if they specialize, cut down the variety, and concentrate their industrial efforts, and they could do this most conveniently within the framework of free trade access to a larger market. In the Canadian case it is obviously the US market that has to be considered, although Canadian economists have been looking in recent years increasingly to Japan also as a possible market; in the case of Australia and New Zealand the orientation is more toward Japan. That general theme emerges with surprising similarity from the different papers we have had from Canada, Australia, and New Zealand.

At the same time, for Australia and New Zealand there is the major problem of markets for their agricultural exports, and here they look obviously to Japan. The Canadian position in agriculture is less serious in-as-much as agricultural problems are less important for Canada, but there still are problems there, and one of our major themes has been the question of possibilities of liberalizing agricultural trade. We devoted one session to that. Here I think the opinions in the conference have been mixed, and a crucial element is the position of Japan.

Japanese economists tends to take the present position as more or less immutable, whereas to the outside observers, as Sir Crawford in fact emphasized, it looks very much as if the present policy will have to be transitional, that with the growth of Japanese income the policy of protecting domestic agriculture heavily will have to go, that foodstuffs are available far more cheaply from outside, particularly from Australia and New Zealand, and that in the interest of the Japanese consumer, liberalization of trade and the exploitation of complementarity in natural resources and skills would indicate a move toward the reduction of barriers to imports of agricultural products. This would be in Japan's interest both in terms of consumer welfare and in terms of increased markets in Japan's industrial exports. The position of Japanese economists is not as decided as the position of Canadian, Australian, and New Zealand on what their countries need, and this is one of the themes we might explore further this morning.

The idea of Pacific Free Trade Area raises the question of world trade policy and how that might evolve. Here the position of the United States is crucial. The American economists took the view that there is a lot of time that the Kennedy Round has still to be digested, and that a second Kennedy Round will prove possible. There is a division of opinion on the evidence of whether the Kennedy Round really marks the end of the phase of the world trade policy (the last step, so to speak, of multilateral non-disciminatory liberalization by negotiation) or whether it marks the first tentative step which could be consolidated much more feasibly once the Common market's position is more settled.

I think that the economists from the other four countries do not feel there is a lot of time and they are not particularly happy to have people in the United States take this view. It became clear that from the standpoint of Canada, Australia, New Zealand, and Japan, there is a hope that the U.S. would provide some positive leadership. We look to the U.S. for leadership, and leadership which consists of saying "there is a lot of time", "delay" and "wait and see" is not satisfactory.

There is also the feeling that given domestic obstacles which inhibit the adoption of progressive trade policies in smaller countries, some leadership from the U.S. would be a great help--a challenge to which other governments would respond. That certainly was the view put forward by Australian speakers, and it is true for Canada also. The United States could at least encourage progressive policies without having to declare itself in favour of trade liberalization in a Pacific Free Trade Area. This would be tremendous stimulus to move public opinion in the direction which economic analysis of the situations in the various countries indicates would be intelligent national policy.

While we talked about the Pacific Free Trade Area several speakers, acknowledging that PAFTA is a long way in the future, have raised the question of what could be done to move toward freer trade in a less comprehensive way, but still on the regional basis, and various ideas have been put forward here: the liberalization of trade in particular sectors among the countries of the region. We have not gone into that in great detail and that, too, is a subject that might be explored a little further.

I think in our discussion, there appeared some differences of opinion. Japanese speakers tended to feel that Canada, Australia and New Zealand did not have much industrial potential, whereas the analysis of both Australian and Canadian economists fairly convincingly established that industrial sectors in those two countries are quite capable of surviving international competition if they have the opportunity to specialize, become less diversified, and do what they do well on a larger scale.

We turned yesterday afternoon away from the question of free trade among the five countries toward the question of the promotion of development. Here, I think, there is again a difference in viewpoint between the Canadian, Australian, and New Zealand representatives, on the one hand, and Japanese and American representatives, on the other, on the question of what the connection between trade and aid is. The way policy is conducted in most countries, trade and aid come under quite separate departments of government and aid policy is thought of as one thing, based on generosity plus self-interest and so forth, and trade policy is thought of as something else. This comes out, among other things, in the fact that we have no qualms about discrimination on regional and national grounds in the giving of aid, but when it comes to the question of trade policy to help developing countries, the principle of non-discrimination stands there, like a powerful obstacle to clear-thinking. In addition, while aid is thought of as involving charity, gift, transfers and so on, trade tends to be thought in highly commercial terms.

The view of the relation between trade and aid that has been emerging in recent years, and here I may be exaggerating the influence on thinking of ideas which have come from Canadian and Australian economists, is that trade and aid are really joint parts of a single operation. Pouring resources into the industrialization of developing countries is going to produce very unsatisfactory results unless, at the same time, changes are made which force the industrialization of these countries to conform to some extent with comparative advantage. That means essentially the combination of aid for development plus the provision of trade opportunities to encourage specialization in development along lines of comparative advantage. The latter has two elements to it at least. One is competition in less developed country markets from foreign suppliers--the discipline of the competition and also demonstration effects--the example of the way other nations do business. The other is that, given the fact of under-development, the national market itself does not provide very much of what is really required for the industrial efficiency.

This second factor really has two aspects to it again, although typically writings on the subject tend to concentrate on one. The first is the question of the large market. Protected national economies do not afford a large market within which competition can occur, and in which the economies of large-scale production and of specialization can be realized. A second, which I think is of great importance and which is being recognized gradually, is that modern industrial production is a matter of extreme specialization within the industrial sector itself, specialization in production of components, parts and inputs of various kinds. To be efficient in the modern world, you need not only a large market in which to sell your products but you also have to have that kind of highly specialized industrial structure from which to obtain components and materials.

What this implies is that the efficient promotion of development in developing countries is not just a matter of giving them resources and letting them forge ahead on the basis of the domestic market. Development strategy based on that concept typically involves excess-diversification, extremely inefficient production of components, potentially efficient operations being handicapped by having to buy inefficiently produced components, and reliance on inefficient credit markets. To make the development effort succeed, you need to combine the contribution of the real resources, which these countries do not have, with the opening of markets, so that development funds can be used in efficient investment, investment which has some hope of leading to the take-off or the self-sustaining stage of the development.

There is some division among us on this question. Looking at Canadian, and Australian experience, you see at a later stage of development the same kind of problem. These are rich countries, but they could be a lot richer particularly if they specialized more and could participate more fully in the world market. Looking back down the line to the developing countries, it seems to be of great importance that we should start at this stage to bring in both trade and aid as complementary things. This, I think, comes out very clearly in the very interesting appendix to Dr. Okita's paper which essentially provides the calculations that that kind of thinking about trade and development suggests. That is, you have the question whether the aid would be effective in developing countries, but also the question whether it will promote growing markets which will enable developed countries themselves to continue along the lines of specialization that they are presently engaged on.

Free Discussion

Free discussion forcussed on two broad issues. First, emphasis was given to the connection between aid-giving and the creation of trading opportunities for less developed countries, and policies designed to integrate aid and trade policy. Second, some questions were raised about the transfer problem and its relation to aid-giving.

It was suggested, particularly by American participants, that complete agreement with Prof. Johnson's view of the importance of trading opportunities for less developed countries was quite consistent with skepticism about the particular form which putting this view into operation has taken in recent years. The appropriate mechanism for inducing less developed countries to specialize in world markets may still not be the provision of preferential access to advanced country markets. Prof. Johnson agreed that his view did not lead automatically to the preference proposal, some variants of which were especially undesirable. If preferential arrangements take the form of quota exemptions from duties, they might have a very bad effect in reinforcing protectionism by providing a protected market of a limited size, whereas what is really required are possibilities for growth by competition on level terms.

Discussion turned to various mechanisms for integrating aid and trade policies. An American participant expressed sympathy with non-discriminatory aid policy and closer connections between trade and aid policy but doubted whether the gap between the two could be bridged both because of the character of international institutions for aid-giving, and because of important and useful differences in the nature of aid policy processes. The former are more flexible, the latter virtually irreversible in the short run. This point was qualified in so far as it seemed feasible for temporary preferences to be extended on a discriminatory basis. Others pointed out that these divisions in the aid and trade policy-making processes in the United States do not apply so clearly in Britain, France, and other countries represented at the conference.

The difficulties associated with outside intervention in the directing of aid-use were also emphasized. Australia was cited as a donor which provides virtually all of her aid in the form of grants dictated by the requests of recipient governments. Such an approach, when there is minimal donor intervention, has its own limitations and frustrations. But it seemed clear that directing the use of aid in the way implied by proposals for linking aid policy to the development of less developed country comparative advantage in world markets, would raise all the delicate problems of intervention and cooperation common to other forms of aid-giving. These need to be thought through very throughly.

A Japanese participant suggested that Japan's aid policy had been oriented toward export promotion in the past. Although the aid-element in Japanese aid-giving had been generally thought to be small, at least there were strong incentives to extend aid-giving along these lines. Following Dr. Okita's paper in the previous session, it was suggested that the emphasis should turn towards export promotion from less developed countries. The concept of "infant export industries" is an accepted rationalization for preferences to less developed country manufactures and semi-processed goods. It might also be applied to primary product imports from less developed countries. Another participant stressed that joint action by Pacific basin countries along these lines would be desirable.

The value of discrimination in aid-giving was stressed particularly for small countries. So too was the value of cooperation in aid-giving among smaller donors, and regionalization or multilateralization in aid-giving through the World Bank or Asian Development Bank. This was thought desirable from the point of view of directing aid into more effective development projects, such as with the Mekong Scheme or Indus River Scheme, and reducing national sensitivities about directing aid-giving.

In addition, others saw the PAFTA proposal as a means of breaking through the aid-trade problem in the Asian-Pacific region. It was argued that if advanced Pacific countries became committed to a substantial regional freer trade arrangement, unilaterally offered free access to their markets for less developed country exports, and used their influence in a few other relevant directions, they would achieve a lot more than ours can be hoped for from UNCTAD discussions at Dehli and after.

Some questions were also raised about the need for countries with balance of payments problems to tie aid. A New Zealand participant suggested that this might at least induce larger aid efforts by more donors. On the other hand others cautioned against the conclusion that the transfer problem is acute in the case of aid but not in the case of trade "aid". The simultaneous and universal adoption of discriminatory preference schemes might lead to very serious transfer problems.

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SCHEDULE OF THE CONFERENCE

January 11, Thursday

Session I Chairman: Leslie V. Castle

"CANADA AND PACIFIC TRADE POLICY"
Reporter : H. Edward English
Discussant : Richard N. Cooper

"CANADIAN TRADE, THE KENNEDY ROUND AND A PACIFIC FREE TRADE AREA"
Reporter : Bruce W. Wilkinson
Discussant : Shigeru Fujii

Session II Chairman, Noboru Yamamoto

"NEW ZEALAND'S TRADE AND AID POLICIES IN RELATION TO THE PACIFIC AND ASIAN REGION"

Reporter : Leslie V. Castle
Discussant : Gustav Ranis

"THE PROSPECTS OF THE ECONOMIC INTEGRATION OF JAPAN, AUSTRALIA AND NEW ZEALAND"

Reporter : Ian A. McDougall
Discussant : Takuji Shimano

Session III Chairman, Hugh T. Patrick

"FINANCIAL ASPECTS OF ECONOMIC COOPERATION AROUND THE PACIFIC"

Reporter : Richard N. Cooper
Discussant : Motoro Kaji

"A PACIFIC BANK FOR INVESTMENT AND SETTLEMENT -- ITS CONCEPTION"

Reporter : Einosuke Ashiya
Discussant : Harry G. Johnson

January 12, Friday

Session IV Chairman: H. Edward English

"A NEW WORLD TRADE POLICY IN THE POST-KENNEDY ROUND ERA: A SURVEY OF ALTERNATIVES, WITH SPECIAL REFERENCE TO THE POSITION OF THE PACIFIC AND ASIAN REGIONS"

Reporter : Harry G. Johnson
Discussant : Bruce W. Wilkinson

"THE AGRICULTURAL GAP IN THE PACIFIC"

Reporter : Kenzo Hemmi
Discussant : John G. Crawford

Session V Chairman: John G. Crawford

"JAPAN'S INTERESTS IN THE PACIFIC TRADE EXPANSION"

Reporter : Kiyoshi Kojima
Discussant : Ian A. McDougall

"PACIFIC ECONOMIC INTEGRATION: AN AUSTRALIAN VIEW"

Reporter : Peter D. Drysdale
Discussant : Hisao Kanamori

Session VI Chairman: Howard P. Jones

"U.S. AID POLICIES IN ASIA"

Reporter : Gustav Ranis
Discussant : Yoichi Itagaki

"JAPAN'S ROLE IN ASIAN ECONOMIC DEVELOPMENT"

Reporters : Saburo Okita and Akira Ohnishi
Discussant : Arthur Paul

January 13, Saturday

Session VII Chairmen: Kiyoshi Kojima and Hugh T. Patrick

Summary of Discussion Sessions I--VI: Harry G. Johnson

Free Discussion.

LIST OF THE PARTICIPANTS

(** Chairman of Organizing Committee)
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H. Edward ENGLISH	- Professor, Carleton University, Canada
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Howard P. JONES	- Chancellor, East-West Center, Hawaii, U.S.A.
Ian A. McDOUGALL	- Professor, Massey University, New Zealand
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